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PUBLIC LANDS ACQUISITION ALTERNATIVE ACT OF 1983

HEARING

BEFORE THE

SUBCOMMITTEE ON
ENERGY AND AGRICULTURAL TAXATION

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

S. 1675

FEBRUARY 6, 1984

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THE PUBLIC LANDS ACQUISITION ALTERNATIVE ACT OF 1983

MONDAY, FEBRUARY 6, 1984

U.S. SENATE,
SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION,
Washington, D.C.

The committee met, pursuant to notice, at 10:01 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Malcolm Wallop presiding.

Present: Senator Wallop.

[The press release announcing the hearing, description of S. 1675 by the Joint Tax Committee, and the prepared statements of Senators Wallop and Baucus follow:]

[Press release No. 84-108, Jan. 18, 1984]

FINANCE SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION SETS HEARING ON S. 1675, PUBLIC LANDS ACQUISITION ALTERNATIVE ACT OF 1983

Senator Malcolm Wallop, Chairman of the Subcommittee on Energy and Agricultural Taxation of the Senate Committee on Finance, announced today that the subcommittee will hold a hearing on Monday, February 6, 1984 on S. 1675, introduced by Senator Wallop for himself and others. S. 1675 would generally provide tax incentives for the contribution of real property to conservation organizations.

In announcing the hearing Senator Wallop noted that, "this legislation is the product of several workshops and hearings concerning alternatives to outright Federal acquisition of natural wildlife habitat and scenic areas. The incredible expense of outright Government acquisition in our present budgetary situation makes it clear that we must search for new and creative ways to protect those worthy areas short of Government acquisition. It is my hope that the hearing on this legislation will help us progress toward the goal of enacting realistic policies which will encourage the protection of some of our most valued national assets."

The hearing will begin at 10 a.m. in room SD-215 of the Dirksen Senate Office Building.

DESCRIPTION OF S. 1675
(PUBLIC LANDS ACQUISITION ALTERNATIVES ACT OF 1983)

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

of the

SENATE COMMITTEE ON FINANCE

On February 6, 1984

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

February 4, 1984

JCX-1-84

INTRODUCTION

The Subcommittee on Energy and Agricultural Taxation of the Senate Committee on Finance has scheduled a public hearing, to be held on February 6, 1984, on S. 1675, the "Public Lands Acquisition Alternatives Act of 1983" (Senators Wallop, Durenberger, and Chafee).

The first part of this document is a summary of S. 1675. The second part is a more detailed description of the bill, including present law, explanation of the bill's provisions, and effective dates.

I. SUMMARY

The value of property donated to charitable organizations generally is deductible for income, gift, and estate tax purposes. Percentage limitations are imposed on the aggregate amount that may be claimed as an income tax deduction in any year. Transfers of less than a donor's entire interest in property are not deductible except in certain specified circumstances; an income tax deduction is permitted for a contribution of a qualified conservation interest. Present law does not include special rules for the tax treatment of gain on a sale of property to a charitable organization for conservation purposes.

S. 1675 would liberalize the income tax rules governing deductions for contributions of partial interests in property and the definition of a qualified conservation contribution; would permit nonrecognition of gain realized on the sale of certain conservation interests to charitable organizations if the seller reinvests the proceeds in other real property; would reduce the portion of long-term capital gains includible in gross income on the sale of certain conservation interests to charitable organizations; would provide an estate tax credit for bequests of certain conservation interests to the United States; and would provide an estate tax deduction for income tax deductions arising from donations of conservation interests which remain unclaimed at the donor's death.

The income tax provisions of the bill generally would apply to transfers occurring after the date of the bill's enactment. The two provisions relating to the tax treatment of gain on certain sales of conservation interests generally would expire ten years after the bill's enactment. The estate tax provisions of the bill would apply to estates of individuals dying after the date of enactment.

II. DESCRIPTION OF S. 1675

Present Law

Deductions for contributions to charitable organizations

General rule

Subject to certain limitations, present law provides a deduction for contributions of property to charitable organizations, to the United States, or to a State or local government. The deduction generally is equal to the fair market value of the property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes (Code secs. 170, 2055, and 2522).

Percentage limitations on aggregate gifts

For income tax purposes, contributions of cash and ordinary-income property by an individual to public charities or to private operating foundations are deductible up to 50 percent of the donor's adjusted gross income. (The 50-percent limitation applies to such contributions made to a private nonoperating foundation only if the donee either redistributes all contributions within a specified period after receipt or qualifies as a "pooled fund" foundation.) For contributions of certain capital-gain property to organizations otherwise qualifying for the 50-percent limitation, the limitation generally is 30 percent. In the case of contributions to private nonoperating foundations (other than the two categories eligible for the 50-percent/30-percent limitations), the limitation is 20 percent.

Contributions by individuals which exceed the 50-percent/30 percent limitations may be carried forward and deducted over the following five years, subject to applicable percentage limitations in those years. Under present law, there is no carryover of excess deduction amounts if the 20-percent limitation applies.

Contributions by corporations are deductible up to 10 percent of the donor's taxable income (determined with certain modifications) for the taxable year, with a five-year carryforward of any excess contributions.

There are no percentage limitations on the amount of charitable deduction for gift or estate tax purposes.

Special rules for donations of property

Gifts of certain types of property interests are subject to special restrictions, either as to the amount deductible or as to types of property interests for which a deduction is permitted.

Under present law, a contribution of a capital asset held by the donor for more than one year prior to the donation (capital-gain property) made to public charities or to private operating foundations is deductible at the asset's full fair market value at the time of the contribution, subject to the 30-percent limitation for all such contributions of capital-gain property. However, in the case of an otherwise qualifying gift of tangible personal property the use of which by the donee is unrelated to its exempt functions, the amount deductible by an individual donor equals the property's fair market value less 40 percent of the amount by which that value exceeds the donor's basis in the property. Also, in the case of donations by individuals of any capital-gain property to private nonoperating foundations (as to which the 20-percent limitation applies), the amount deductible equals the asset's fair market value reduced by 40 percent of the amount by which the value exceeds the donor's basis in the property. The deduction for gifts of ordinary-income property (such as inventory) generally is limited to the donor's basis in the property.

A contribution of less than the donor's entire interest in property generally does not give rise to a charitable deduction (for income, estate, or gift tax purposes) unless the gift takes the form of an interest in a unitrust, annuity trust, or a pooled income fund. Exceptions to the partial interest rule are provided for gifts of remainder interests in farms or personal residences, gifts of undivided portions of the donor's entire interest in the property, and, for income tax purposes, gifts of qualified conservation interests.

Qualified conservation interests

Under present law, qualified conservation interests are real property interests donated in perpetuity for any of the following conservation purposes--

a. The preservation of land areas for outdoor recreation by, or for the education of, the general public;

b. The protection of a natural habitat of fish, wildlife, plants, or a similar ecosystem;

c. The preservation of open space (including farmland and forest land) but only if such preservation (1) either is for the scenic enjoyment of the general public, or is pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and (2) will yield a significant public benefit; or

d. The preservation of an historically important land area or a certified historic structure (sec. 170(h)).

Deductible conservation interests may take any of three forms. First, the value of a remainder interest is deductible. Second, the value of a restriction (e.g., an easement) granted in perpetuity on the use of the property is deductible. Finally, the contribution of the donee's entire interest is deductible, except that the donor may retain his or her interest in subsurface oil, gas, or other minerals and the right of access to such minerals. If a donor retains mineral interests, surface mining must be precluded on the property.

Nonrecognition of gain in certain transactions

Present law permits nonrecognition of gain realized on certain dispositions of property. Taxpayers are not required to recognize gain on a "like-kind" exchange of business or investment property (sec. 1031). This nonrecognition treatment applies only to the extent that the property is disposed of for other like-kind property for use in a trade or business or for investment; gain is recognized to the extent that other property or money is received in the exchange. Additionally, a carryover basis applies to the property acquired in a like-kind exchange.

Gain is not recognized in the case of involuntarily converted property if property similar or related in use is received (sec. 1033). This nonrecognition treatment also is available if money or another type of property is received and the taxpayer acquires property similar in use to the involuntarily converted property within two years after the taxable year in which the conversion occurred.

Taxation of long-term capital gains

Gains or losses on certain assets held more than 12 months are considered long-term capital gains or losses (secs. 1221-23).

For noncorporate taxpayers, 40 percent of net long-term capital gains are included in gross income, while 100 percent of net short-term gains are included. Also, for noncorporate taxpayers, 100 percent of net short-term losses, and 50 percent of net long-term losses, are deductible, up to a maximum of $3,000 in a year (with a carryover of any excess net capital losses).

For corporate taxpayers, net long-term gains are subject to an alternate tax rate of 28 percent, while net short-term gains are taxed at ordinary corporate rates. A corporation can use capital losses for a taxable year only to offset capital gains, with a carryover for unused capital losses.

Explanation of Provisions

Overview

S. 1675 would liberalize the income tax rules governing deductions for contributions of partial interests in property and the definition of a qualified conservation contribution; would permit nonrecognition of gain realized on the sale of certain conservation interests to charitable organizations if the seller reinvests the proceeds in other real property; would reduce the portion of long-term capital gains includible in gross income on the sale of certain conservation interests to charitable organizations; would provide an estate tax credit for bequests of certain conservation interests to the United States; and would provide an estate tax deduction for income tax deductions arising from donations of conservation interests which remain unclaimed at the donor's death.

Income tax provisions

Increase in percentage limitations on aggregate gifts

In the case of a qualified conservation contribution of long-term capital gain property which under present law is subject to the 30-percent limitation, the bill would allow a charitable deduction in the year of the gift of up to 50 percent of the individual donor's contribution base, reduced by the percentage represented by any other gifts of capital-gain property during the year qualifying for the existing 30-percent limitation. For example, if an individual whose contribution base is $400,000 contributes during the year $120,000 in appreciated stock to a university and $100,000 in appreciated land to a qualified organization for conservation purposes, the bill would allow an additional deduction (as compared to present law) for the year of 20 percent, or $80,000.

Also, the bill would provide an unlimited carryover of excess deductions for qualified conservation contributions ($20,000 in the example), in place of the general five-year carryover under present law.

Modification of restrictions on types of deductible conservation interests

Under the bill, any contribution of a qualified property interest to the United States, or to a State or political subdivision of a State, for preservation of open space would be treated as meeting the requirements that the contribution must either be made for the scenic enjoyment of the general public or must be made pursuant to a clearly delineated public policy, and must yield a significant public benefit.

Additionally, the bill would repeal, as a condition for a deduction, the present prohibition of surface mining on donated property where the donor retains mineral interests in the land.

Expansion of types of partial interests in property with respect to which a deduction may be claimed

The types of partial interests in property with respect to which a charitable deduction may be claimed would be expanded to include contributions of a donor's entire interest other than mineral interests, i.e., to include contributions of the surface interest in land where another person (such as the Federal Government) owns the mineral rights. Under the bill, such contributions of the surface interest in land would be deductible under the same rules applicable to other gifts of capital-gain property, without regard to the rules governing conservation contributions or the nature or ownership of any mineral interests in the land. However, in order for the increased tax incentives under the bill to apply (such as the 50-percent limitation), the transfer would have to satisfy the requirements applicable under section 170(h) to qualified conservation contributions.

Nonrecognition of gain on certain sales

A new provision would be added to the Code permitting nonrecognition of long-term capital gain on the sale of any qualified real property interest to a qualified organization for use exclusively for conservation purposes if, within three years after the close of the taxable year of the sale, the seller purchased any real property to be held for investment.

Qualified real property interests would include outdoor recreational areas and areas sold for the preservation of natural habitats or open space which would qualify for an income tax deduction if contributed to a charitable organization. Gain from sales of certified historic structures or historically important land areas (other than areas described above) would not qualify for nonrecognition. Unlike the existing rules for like-kind exchanges and involuntary conversions, the replacement property acquired under the nonrecognition provision of the bill would not be limited to property of a like kind or property similar in use to the transferred property.

This nonrecognition provision of the bill generally would expire ten years after the date of the bill's enactment. The sunset provision would not apply, however, to sales of the taxpayer's entire interest in property remaining after a qualified conservation contribution.

Increase in capital gains deduction on certain sales

The portion of long-term capital gain includible in gross income would be reduced from 40 percent (present law) to 30 percent on a sale or exchange by a noncorporate taxpayer of any qualified real property interest to a qualified organization exclusively for conservation purposes. Accordingly, the maximum effective tax rate on the gains from such dispositions would be reduced from 20 percent (present law) to 15 percent. The term qualified real property interests would have the same meaning as in the nonrecognition provision (discussed above).

This provision of the bill generally would expire ten years after the date of the bill's enactment. The sunset provision would not apply, however, to sales of the taxpayer's entire interest in property remaining after a qualified conservation contribution.

Estate tax provisions

Credit for certain conservation contributions

The bill would provide a new credit against the estate tax for bequests of certain qualified conservation interests to the United States.

The credit would apply to transfer of any interest that would have given rise to an income tax deduction under section 170(h) had the decedent transferred the interest immediately before his or her death. Unlike the income tax deduction, however, no limits would be imposed on the amount of estate tax that could be offset by the credit. Additionally, with the credit, tax would be reduced dollar-for-dollar by the value of the contribution, rather than only by the transferor's marginal tax rates (as is the case with a deduction).

Deduction for certain unused income tax deductions

A new estate tax deduction would be provided for any carryovers of allowable income tax deductions arising from contributions of conservation interests which remain unused at the time of the donor's death. These unused income tax deductions would be treated as if they were devises to charitable organizations. Therefore, like other estate tax charitable deductions, no percentage limitations would be imposed on the amount of the deduction that could be claimed.

Effective Dates

The income tax provisions of the bill generally would apply to transfers occurring after the date of the bill's enactment. The two provisions relating to the tax treatment of gain on certain sales of conservation interests would expire ten years after the bill's enactment (except for a sale of interests remaining in property with respect to which a conservation contribution previously been made by the seller).

The bill's estate tax provisions would apply to estates of individuals dying after the date of enactment.

STATEMENT OF SENATOR MALCOLM WALLOP, CHAIRMAN, SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION OF THE SENATE FINANCE COMMITTEE

It is my pleasure today to welcome all of you here to this hearing on S. 1675, the "Public Lands Acquisition Alternatives Act of 1983", introduced by myself, and my Finance Committee colleagues, Senator Chafee and Senator Durenberger. As most of you here are aware, my interest in exploring alternatives to outright acquisition of scenic lands and natural habitat has been longstanding. Hearings and workshops conducted through the Public Lands subcommittee of the Senate Energy Committee have been held over the past several years. As a direct result of those forums I introduced tax legislation, similar to that which is the subject of this hearing, at the end of the 97th Congress in 1982. Although that legislation was introduced too late for any substantive action by the Congress, it framed many of the tax tools which were explored during the course of those earlier workshops, and provided a sounding board for the development of S. 1675.

Direct purchase of scenic lands and wildlife habitat has been by far the most widely used tool of the federal and state governments, as well as conservation organizations in the preservation of those areas. As development demands have increased, the cost of preventing development has increased as well. And at the same time, competition for available resources to purchase significant natural areas has clearly outstripped the ability of even the federal government to acquire those which are currently authorized for purchase. In light of the present and forecasted federal deficits, it would not appear that the competition for these scarce funds is going to diminish any time in the foreseeable future. And the states find themselves in a much similar situation. And conservation organizations which have done so much in the recent years are finding the variability to fund major acquisitions is diminishing as well.

The message could not be clearer—if we are going to tackle the task of preserving many of these precious resources in light of current pressures for development and the competition for funds, we have to identify and enact the efficient tools to accomplish this task. I believe that S. 1675 contains such an opportunity.

Building on the broad principles found in the Tax Treatment Extension Act, which provides for the deductibility of contributions of partial interest in real property, we have sought with S. 1675 to put together a variety of tax incentives to further encourage the sale and contribution of significant natural areas. Those principles which I believe must remain intact as we seek viable alternatives to encourage and promote tax motivated transfers of scenic lands and wildlife habitat, contemplate that tax benefits are provided only with regard to carefully defined natural areas. And that a sale or contribution qualifying for special treatment must be for a conservation purpose. And that the recipient must be qualifed to manage the resource, and that the recipient must have the commitment and the resources to enforce the conservation purpose.

With those fundamental concepts in mind, S. 1675 would provide the following tax incentives for the sale and contribution of significant natural areas:

The allowable deduction for charitable contributions of long-term capital gains property for qualified conservation purposes would be increased from the current level of 30 percent of adjusted gross income to 50 percent of adjusted gross income.

The current five year limit on carryovers of unused charitable deductions would be entirely eliminated with respect to contributions of qualified conservation property.

As currently contained in the Tax Treatment Extension Act, a donation is not a "qualified conservation contribution" if there is a possibility of future mineral removal by surface mining. S. 1675 would remove that limitation, but would preserve the general policy that the conservation purpose must be maintained. In essence, the new language would allow contributions of a surface estate where it was apparent that the probability of significant surface disruption was remote.

The gift by an estate of "qualified conservation property" to the federal government could be used to offset federal estate tax liability on a dollar for dollar basis—in essence as estate tax credit.

Unused charitable contributions at the time of death would be allowed to reduce the taxable estate to the extent those contributions were "qualified conservation property."

Sale of conservation property for conservation purposes would be free from long-term capital gains recognition, if the proceeds from the sale are invested in investment property within the next three years. Because of the need to encourage immediate transfers this section would sunset 10 years after enactment.

Finally, the sale of qualified conservation property would be entitled to a reduced maximum long-term capital gains rate if the reinvestment option is not exercised. The rate reduction would impose a maximum 15 percent tax rate compared with the present 20 percent rate.

While there are some further minor changes in the law contemplated by the bill, the major changes being suggested are expansive, and, to some extent quite complicated. Because of the variables involved it is, at best, difficult to estimate the possible cost to the federal purse enactment of this legislation may mean. But, in light of our present budgetary predicament I believe it is safe to say that if we are going to crack the tax code with this legislation we probably won't be able to carry every provision in this bill into law. As those scheduled to appear before the Committee come forward with their comments, I would hope that you will offer your expertise in highlighting the individual provisions which you think offer the greatest return. It is an unfortunate fact of life, but we must prioritize.

When I speak of priorities I do not mean to diminish the importance of implementing the law we already have on the books. Many of you have been working with my office, and the Treasury Department in resolving some of the problems that were identified with the proposed regulations for the Tax Treatment Extension Act. To the credit of the Treasury Department, they have been very helpful and patient in that process. Unfortunately, we will not have them here today to comment on the status of the regulations, nor will we have them here to offer the Administration position on this legislation. Between their ongoing work on the Administration budget, and some communications problems within the bowels of the Treasury Department they have asked that their testimony be submitted at a later date. When that happens I will make every attempt to see that those comments are made available to everyone who has an interest in their content.

In conclusion I think it is important for all of us to remember that the great resources we as a country enjoy are not held there for our current consumption, but are held in trust by us for generations to come. If we do not take affirmative actions to preserve that legacy, we lose that chance forever. I believe this legislation can help us meet our responsibility to tomorrow, and I look forward to the insights of those who will come before the Subcommittee today.

STATEMENT OF SENATOR MAX BAUCUS,

INTRODUCTION

Mr. Chairman, I want to thank you for calling this hearing.

And I also want to thank you for your steady work to promote innovative methods, like conservation easements, to protect the resources and heritage of the Mountain West.

CONSERVATION EASEMENTS IN MONTANA

In Montana, we know how important a task this is.

Too often, we've seen Eastern barons drain away our resources and leave behind nothing but abandoned stripmines.

To fight back, we've developed devices to protect our resources and our heritage.

One is the conservation easement. This device allows a landowner to voluntarily donate his development rights to a conservation group. In return, he receives a tax deduction equal to the value of the development rights.

Montana's Land Reliance and Nature Conservancy, have been at the forefront of America's conservation easement movement. Already, they have obtained easements protecting almost 50,000 acres of prime Montana land. Recently, the Land Reliance obtained an easement over the 7,000-acre Hilger Ranch outside Helena.

LEGAL ISSUES

Such easements are a good example of cooperation among landowners, conservation groups, and Government.

Unfortunately, some problems remain.

To be widely used, conservation easements much be tax-deductible. Congress has repeatedly declared that they are, most recently in 1980.

However, the Treasury Department has issued proposed regulations, implementing the 1980 law, that could sharply curtail the use of conservation easements, especially in the West.

For example, one proposed provision prevents a landowner from deducting the value of a conservation easement if he doesn't own the mineral rights beneath his land. In the West, the Federal Government or some other entity frequently owns the mineral rights beneath the land. So many, many landowners would be ineligible, even it there's only a remote possibility that mining will occur and been if any mining that does occur would be entirely consistent with the easement's conservation purpose.

I understand that representatives of Department of the Treasury have met with Western Conservation groups to discuss this and other problems. And I also understand that, as a result of these discussions, some progress may have occured.

I hope that progress continues, so that Treasury can soon publish final regulations that address these problems satisfactorily. Otherwise, Congress may have to act again.

S. 1675

We shouldn't stop with the proposed regulations. We should consider other ways to promote private conservation efforts.

In this regard, S. 1675 is a major contribution. It would solve the third party Mineral interest problem. And it also would do much more: clarify the rules about donations to governments, clarify the rules about surface mining and create greater tax incentives for donating and or land development rights. These proposed changes deserve careful consideration by the Finance Committee.

CONCLUSION

Mr. Chairman, I welcome the opportunity to consider the changes you propose in S. 1675, and to discuss the proposed Treasury regulations. And I look forward to Treasury's pending testimony about these issues. I may have some questions to submit, to Treasury, after we receive that testimony.

Senator **Wallop**. Good morning. It is my pleasure today to welcome all of you to this hearing on S. 1675, the Public Lands Acquisition Alternative Act of 1983, which I introduced along with my Finance Committee colleagues, Senators Chafee and Durenberger.

As most of you here are aware, my interest in exploring alternatives to outright acquisition of scenic lands and nature habitat has been long standing. Hearings and workshops were conducted through the Public Lands Subcommittee of the Senate Energy Committee over the past several years. And as a direct result of those forum, I introduced tax legislation similar to that which is the subject of this hearing at the end of the 97th Congress in 1982.

Although that legislation was introduced too late for any substantive action by the Congress, it frames many of the tax tools which were explored during the course of those earlier workshops, and provided a sounding board for the development of S. 1675. Direct purchase of scenic lands and wildlife habitat has been by far the most widely used tool of the Federal and State Governments, as well as conservation organizations in the preservation of those areas. As development demands have increased, the cost of preventing development has increased as well. And at the same time, competition for available resources to purchase significant natural areas has clearly outstripped the ability of even the Federal Government to acquire those which are currently authorized for purchase. I was reminded of that by a trip to the west coast over the weekend, and saw there the Channel Islands, and flew over some of the Santa Monica area. And if this country continues to do what I consider an immoral act, which is simply to take those lands from those people—and they remain taxpayers on them, but they can't sell them because no other use but their present use can be made. And they can't develop them. They can't do anything at all. They just simply are in possession of the ultimate white elephant. And we have created that. And I believe that it is wrong.

In light of the present and forecasted Federal deficits, it would not appear that the competition for these scarce funds is going to diminish any time in the foreseeable future. And the States find themselves in a much similar situation. And conservation organizations which have done so much in the recent years are finding the variability to fund major acquisitions is diminishing as well.

The message could not be clearer. If we are going to tackle the task of preserving many of these precious resources in light of current pressures for development and the competition for funds, we have to identify and enact the most efficient tools to accomplish this task. I believe that S. 1675 contains such an opportunity. Building on the broad principles found in the Tax Treatment Extension Act, which provides for the deductibility of contributions of partial interest in real property, we have sought with S. 1675 to put together a variety of tax incentives to further encourage the sale and contribution of significant natural areas.

Those principles which I believe must remain in tact as we seek viable alternatives to encourage and promote tax motivated transfers of scenic lands and wildlife habitat contemplate that tax benefits are provided only with regard to carefully defined natural areas. And that a sale or contribution qualifying for special treatment must be for a conservation purpose. And that the recipient must be qualified to manage the resource, and that the recipient must have the commitment and the resources to enforce the conservation purpose.

With those fundamental concepts in mind, S. 1675 would provide the following tax incentives for the sale and contribution of significant natural areas:

One, the allowable deduction for charitable contributions of long-term capital gains property for qualified conservation purposes would be increased from the current level of 30 percent of adjusted gross income to 50 percent of adjusted gross income.

Two, the current 5-year limit on carryovers of unused charitable deductions would be entirely eliminated with respect to contributions of qualified conservation property.

As currently contained in the Tax Treatment Extension Act, a donation is not a qualified conservation contribution if there is a possibility of future mineral removal by surface mining. S. 1675 would remove that limitation, but would preserve the general policy that the conservation purpose must be maintained. In essence, the new language would allow contributions of a surface estate where it was apparent that the probability of significant surface disruption was remote.

The gift by an estate of qualified conservation property to the Federal Government could be used to offset Federal estate tax liability on a dollar-for-dollar basis—in essence tax credit.

Unused charitable contributions at the time of death would be allowed to reduce the taxable estate to the extent those contributions were qualified conservation property.

Sale of conservation property for conservation purposes would be free from long-term capital gains recognition, if the proceeds from the sale are invested in investment property within the next 3 years. Because of the need to encourage immediate transfers this section would sunset 10 years after enactment.

And, finally, the sale of qualified conservation property would be entitled to a reduced miximum long-term capital gains rate if the reinvestment option is not exercised. The rate reduction would impose a maximum 15-percent tax rate compared with the present 20-percent rate.

While there are some changes, minor changes, in the present law contemplated by the bill, the major changes being suggested are expansive, and, to some extent quite complicated. Because of the variables involved it is, at best, difficult to estimate the possible cost to the Federal purse enactment of this legislation may mean. But, in light of our present budgetary predicament, I believe it is safe to say that if we are going to crack the Tax Code with this legislation we probably won't be able to carry every provision of the bill into law. As those scheduled to appear before the committee come forward with their comments, let me ask you to offer your expertise in highlighting the individual provisions which you think offer the greatest return, and the complications. But as an unfortunate fact of life, we must prioritize.

When I speak of priorities, I do not mean to diminish the importance of implementing the law we already have on the books. Many of you have been working with my office and the Treasury Department in resolving some of the problems that were identified with the proposed regulations for the Tax Treatment Extension Act. To its credit, Treasury has been very helpful and patient in that process. Unfortunately, we will not have them here today to comment on the status of the regulation, nor will we have them here to offer the adminstration's position on this legislation. Between their ongoing work on the administration's budget, and some communications problems within the bowels of the Treasury Department, they have asked that their testimony be submitted at a later date. When that happens, I will make every attempt to see that those comments are made available to everyone who has an interest in the content.

Let me conclude by saying that I think it is important for all of us to remember that the great resources we as a country enjoy are not held there for our current consumption, but are held in trust by us for generations yet to come. If we do not take an affirmative action to preserve that legacy, we may lose that chance forever. Now I belive this legislation can help meet that responsibility to tomorrow, and I look forward to the insights of those who will come before the subcommittee today.

And the first is a panel consisting of Mr. Kingsbury Browne, counsel for the Land Trust Exchange, Mount Desert, Maine; and Mr. Bill Reilly, president of the Conservation Foundation, Washington; Mr. L. Gregory Low, who is the executive vice president of Nature Conservancy in Washington; and Mr. Ed Thompson, counsel to the American Farmland Trust, Washington, D.C.

Gentlemen, if you would please step forward and present your testimony. Let me say I welcome you here, and I thank you for your expertise.

Mr. Reilly, would you like to proceed?

STATEMENT OF WILLIAM K. REILLY, PRESIDENT, THE CONSERVATION FOUNDATION, WASHINGTON, D.C.

Mr. REILLY. I am William Reilly, president of the Conservation Foundation in Washington. I think I'm going to talk at a higher level of generalities than the tax experts on this panel, of which I am not, and my staff are not.

I appreciate very much the opportunity to be here and to comment on Senate bill 1675 and some of the broader issues involved in providing additional tax incentives for land conservation. This issue has progressed under your leadership, Senator Wallop, through the workshops on land management and acquisition you have conducted as chairman of the Subcommittee on Public Lands and Reserve Waters in 1981 and 1982 and for which I was fortunate to serve as a moderator of several of those sessions. You are to be commended for taking those forums the next step further with this bill and this hearing.

The papers and discussions at those workshops focused in part on the increasing role tax incentives are playing and can play in land conservation efforts. And as you remember, I, along with Pat Newnan and Emery Castle reported back after the workshops that various panelists agreed with regard to tax policy that: it was in the national interest to encourage land preservation and conservation through private as well as Federal appropriations and Federal administration of land; conservation practices should be made more profitable to landowners via the provision of tax incentives; and there is a need to clear up some of the problems already identified with existing tax legislation as well as to provide new tax benefits to stimulate land conservation by private property owners.

Thus, I'm delighted to see provisions in S. 1675 designed to encourage land for conservation. Section 4, for example, would enable the executor of an estate to donate a conservation easement or a portion or all of the land to the Federal Government and receive a credit toward the estate tax due equal to the fair market value of the donated interest. It should provide an important incentive for keeping land for conservation uses rather than having to see it to pay the estate taxes.

Similarly, section 2 of S. 1675, which increases the deduction for individual contributions from 30 percent to 50 percent and allows the excess to be spread over as many succeeding years as necessary rather than just 5 years, addresses this situation, and should also be helpful. In addition, allowing the value of open space easements donated to governments to be automatically deductible from taxable income would help to clear up some of the confusion that has resulted in the implementation of the current law.

For the record let me make it clear that I speak as a conservationist and I don't claim expertise in the workings of the Internal Revenue Code. Much as I welcome the advances in S. 1675, I frankly wish it were feasible to provide more ambitious tax incentives for land conservation at this time. The remaining minutes I have I would like to suggest some steps that would, in my judgment, facilitate a broader, more far-reaching approach to this need.

The crucial need, as you stated in introducing this legislation last July, is to determine the governmental cost in foregone revenues and the resulting benefits to conservation. From this we can better assess the value of the tax expenditures and whether alternatives might be more suitable and cost effective.

Several components of looking at cost and benefits need to be studied. First, there are administrative costs in tax programs, and these should be included in the analysis. For example, the Advisory Council on Historic Preservation issued a report in 1983 to the President and the Congress on Federal tax law and historic preservation that evaluated the various tax incentives for preserving buildings. We are beginning to accumulate sufficient experience with the tax incentives for land conservation, and should undertake a similar effort with regard to them.

Second, a thorough conservation lands inventory is needed. This is one of the findings of the Conservation Foundation's comprehensive look at the national park system, a study that will be released later this spring. Identifying appropriate conservation areas, an issue raised in the workshops you held, is necessary to assure that Federal tax expenditures are allocated to the most valuable acres. Such identification, drawing on various inventories conducted by Federal and State agencies and by the Nature Conservancy, is, I believe, a legitimate role for the Federal Government. Identification of properties through the National Register of Historic Places, which is under Park Service jurisdiction, has been of central importance to the successful implementation of tax incentives for rehabilitating and preserving historic structures. The Park Service should play a similar role in land conservation as well.

In deciding which lands are most suitable for conservation, the inventory process will need to address complex issues. These may include the quality of the resources, the need for additional protection, and local impacts, among others. Public access to conservation areas promises to be particularly a thorny question. One of the great attributes of America's Federal conservation lands is the access they afford citizens. And this must not be lost. There are, however, a variety of public benefits associated with land conservation, even when access is not provided. The inventory process will need to make some effort to evaluate these benefits.

The inventory process might lead to additional benefits as well. The 1980 National Park Service report disclosed that a majority of threats to park resources originate on land outside park boundaries. An inventory might permit the Federal Government to designate lands, zones, if you will, adjacent to specified national parks and perhaps wildlife refuges where land development would have particularly serious impacts on park resources. Congress might then experiment with provisions allowing especially generous tax incentives for conservation of seriously threatened land within these zones.

Finally, in determining cost and benefits of conservation incentives, it is important to consider potential abuses. The National Trust for Historic Preservation through its publication Preservation News just last month called attention to actual abuses of preservation law incentives. As the trust put it:

> A few well-publicized fleecings can kill a well-intentioned program—even when that is applied honestly and thoughtfully, as are preservation incentives, more than 99 percent of the time.

We must do what we can to guard against such abuses.

As the recovering economy intensifies development pressures, I expect the need for land conservation to become increasingly clear. To provide incentives for protecting that neither miss the mark nor waste Federal dollars, this inventory effort should begin without delay.

Let me reiterate my strong support for your continuing efforts to conserve America's land.

Thank you very much.

Senator WALLOP. Thank you, Bill. I will save the questions until we have heard from the whole panel.

[The prepared statement of Mr. Reilly follows:]

Statement of William K. Reilly, President
of The Conservation Foundation, Before the
Senate Finance Committee on S.1675 and Related Tax Incentives for Land Conservation
Delivered February 6, 1984

I appreciate the opportunity to be here and comment on Senate bill 1675 and some of the broader issues involved in providing additional tax incentives for land conservation. This issue has progressed, under Senator Wallop's leadership, through the workshops on land management and acquisition he conducted as chairman of the Subcommittee on Public Lands and Reserved Waters in 1981 and 1982 and for which I was fortunate to serve as a moderator of several of the sessions. Senator Wallop is to be commended for taking those forums the next step further with this bill and hearing.

The papers and discussions at those workshops focused in part on the increasing role tax incentives are playing and can play in land conservation efforts. As you remember, I, along with Pat Noonan and Emory Castle, reported back after the workshops, that various panelists agreed with regard to tax policy that:

- It was in the national interest to encourage land preservation and conservation through private--as well as federal appropriations and federal administration of land;

- Conservation practices should be made more profitable to landowners via the provision of tax incentives;
- There is a need to clear up some of the problems already identified with existing tax legislation as well as to provide new tax benefits to stimulate land conservation by private property owners.

Thus, I am delighted to see provisions in S.1675 designed to encourage land for conservation. Section 4, for example, would enable the executor of an estate to donate a conservation easement or a portion or all of the land to the federal government and receive a credit toward the estate tax due equal to the fair market value of the donated interest. It should provide an important incentive for keeping land in conservation uses rather than having to sell it to pay the estate taxes.

Similarly, Section 2 of S.1675, which increases the deduction for individual contributions from 30 percent to 50 percent and allows the excess to be spread over as many succeeding years as necessary rather than just five years, addresses this situation and should also be helpful. In addition, allowing the value of open space easements donated to governments to be automatically deductible from taxable income would help to clear up some of the confusion that has resulted in the implementation of the current law.

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Much as I welcome the advances in S.1675, I frankly wish it were feasible to provide more ambitious tax incentives for land conservation at this time. In the remaining minutes I have, I would like to suggest steps that would, in my judgment, facilitate a broader, more far-reaching approach to this need.

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Several components of looking at costs and benefits need to be studied. First, there are administrative costs in tax programs and these should be included in the analysis. For example, the Advisory Council on Historic Preservation issued a report in 1983 to the President and the Congress on Federal Tax Law and Historic Preservation that evaluated the various tax incentives for preserving buildings; we are beginning to accumulate sufficient experience with the tax incentives for land conservation and should undertake a similar effort with regard to them.

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Finally, in determining cost and benefits of conservation incentives, it is important to consider potential abuses. The National Trust for Historic Preservation, through its publication Preservation News, just last month called attention to actual cases of abuse of preservation tax incentives. As the Trust put it, "A few well-publicized fleecings can kill a well-intentioned program--even when that is applied honestly and thoughtfully, as are the preservation incentives, more than 99% of the time." We must do what we can to guard against such abuses.

As the recovering economy intensifies development pressures, I expect the need for land conservation to become increasingly clear. To provide incentives for protecting that neither miss the mark nor waste federal dollars, this inventory effort should begin without delay.

For the present, let me reiterate my support for Senator Wallop's continuing efforts to conserve America's land. Thank you very much.

STATEMENT OF GREGORY LOW, EXECUTIVE VICE PRESIDENT, NATURE CONSERVANCY, WASHINGTON, D.C.

Mr. Low. Mr. Chairman, my name is Greg Low. I'm executive vice president of the Nature Conservancy. And we greatly appreciate the opportunity to present our views to you today. And we, too, commend you for your leadership in moving forward the much needed tax incentives for natural area conservation in the United States.

The Nature Conservancy is a national nonprofit, private conservation organization dedicated to the preservation of ecologically significant natural areas, and the significant life forms that they contain.

The conservancy, Mr. Chairman, has preserved over 2 million acres of significant natural land. Last year alone, we acquired over 140,000 acres with an estimated value of approximately $42 million.

Our chief enemy in our mission of preserving America's natural diversity is time. And because our enemy is time, the incentives that you are suggesting in Senate bill 1675 add very needed arrows to the conservation quiver. And we applaud your efforts and encourage you to move forward vigorously in implementing the legislation.

Mr. Chairman, you asked that we try to set priorities among these arrows that you are suggesting be added to the conservation quiver. And I would suggest that we give strong consideration to the complete package, if possible. I think you will find when your staff conducts the studies on the cost in terms of lost tax revenues that these costs are very, very modest. And the cost of an individual arrow to be particularly modest compared to the tremendous gains that they will entail.

What we need is a, I would paraphrase, tool box of wrenches and screwdrivers that we can go out with when we do our business. And to delete any one of the tools that you suggested might not hurt in a larger sense, but dealing with a particular landowner, you need all the tricks that you can have at your disposal.

If there were one provision above all that we had to set as the top priority, I think our conclusion would be that the allowability of deductions up to 50 percent of adjusted gross income versus the 30 percent would be the most important provision. And the reason for this is as follows:

I will give you an example in the State of Indiana. The conservancy has conducted a very detailed inventory along the lines that Mr. Reilly suggested in the State in cooperation with the State of Indiana. This inventory is now a part of the State government. It was done with our assistance. We have identified approximately 200 natural areas in Indiana that are needed to round out the system of nature preserves in that State to set aside examples of Indiana as it was found when our forefathers settled the State. Governor Orr has introduced legislation where the conservancy and the State would work together to accomplish this mission. We are talking about less than 15,000 acres, Mr. Chairman. And we are talking about typically very small sites owned by landowners, farmers of moderate means. These individuals frequently, not being in high-income levels, need all the help they can get to encourage a charitable contribution.

To the extent that the 30-percent cap makes it less able for them to write off their contribution, it hurts the small landowner. So the 50-percent limitation versus the 30-percent limitation would be a big help in our work with small landowners across the country.

You asked for our priorities and so we reluctantly give this as the top priority. Again, I urge the entire package for consideration.

It's very important, as you know, and as you stimulated in your workshops, that we have tools available to us besides the outright purchase of land through fee acquisition. This is an important and absolutely critical method that we use in our work. It accounts for about 80 percent of our business. But to the extent that we can increase the donations from 20 percent of the land that we protect to a figure maybe as high as 40 percent, not only would we save many more areas, we would save them more quickly, and we would save them, we think, ultimately at lower costs to all Amcricans.

Mr. Chairman, I, or our tax counsel, would be delighted to work with you and your staff in any way to help provide program information about any of the provisions of this legislation. And we thank you for the opportunity, and hope the bill will pass.

Senator WALLOP. Thank you, Mr. Low.

[The prepared statement of Mr. Low follows:]

The Nature Conservancy

1800 North Kent Street, Arlington, Virginia 22209
(703) 841-5300

STATEMENT SUBMITTED TO THE SENATE SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION, SENATE COMMITTEE ON FINANCE

February 6, 1984
by L. Gregory Low, Executive Vice President
The Nature Conservancy

Mr. Chairman, members of the Subcommittee, my name is Greg Low. I am the Executive Vice President of The Nature Conservancy. The Nature Conservancy is grateful for this opportunity to present our views on S. 1675, which Senator Wallop has introduced. The Nature Conservancy is a national, private, non-profit conservation organization dedicated to the preservation of ecologically significant natural areas and the diversity of life they support. Since 1954, The Nature Conservancy has preserved over 2 million acres of such land. We are the owners of the largest private nature preserve system in this country, consisting of over 700 preserves, totaling more than 400,000 acres. We are the largest private purchaser of natural lands for conservation in this country. Last year alone we acquired over 140,000 acres with a fair market value of approximately $42 million.

The Nature Conservancy believes that the preservation of natural diversity is one of the most critical issues facing this country, indeed, the world. Our enemy in this mission is time. There is more and more pressure on the country's natural resources as we continue to develop and progress. A new city the size of 100,000 is added to our population every two to three weeks. If we are to save what is critical--preserve the rich natural diversity of this country--it must be done soon or we will lose our chance. Harvard biologist E. O. Wilson has stated: "The one process ongoing in the 1980s that will take millions of years to correct is the loss of genetic and species diversity by the destruction of our natural habitats. This is the folly our descendents are least likely to forgive us."

This is why the Conservancy strongly endorses the concepts inherent in S. 1675. The most effective tool in conservation preservation has been the purchase of land. But, in our opinion, acquisition alone will simply not be an adequate tool in the long run to get the job done. S. 1675 proposes to add more arrows to the conservation quiver, and for that reason we applaud Senator Wallop's efforts.

As the largest private purchaser of natural lands for conservation, we believe that our experience may be useful to the Committee's deliberations. Since 1971, the Conservancy has preserved over 1,161,000 acres. Of that total, only 20% were donated outright to us, requiring that purchase be used in all other cases. These donations occurred under the past and current tax provisions. We believe that figure and, therefore, our ability to save even more critical acres would substantially increase with the passage of additional charitable tax incentives such as those in S. 1675.

The need to find alternatives to acquisition as a preservation tool has long been an issue. Senator Wallop has identified this need. In October, 1981, and June, 1982, he held workshops in the Energy and Natural Resources Committee to discuss various alternatives. These workshops, in which the Conservancy participated, provided an excellent platform for an exchange of ideas among many experts in the land preservation field. It was generally accepted within the conservation community that acquistion by purchase alone will not be sufficient to do the job. Alternatives need to be aggressively pursued. Amending the IRS Code to encourage conservation activity, as S. 1675 proposes to do, is an excellent first step.

I would like to turn my attention now to specific features of S. 1675. The Conservancy is strongly in favor of the following provisions contained in S. 1675.

1. Increasing from 30% to 50% the allowable deduction for gifts of land from a write-off against adjusted gross income.

2. An unlimited carry-forward for gifts of conservation lands. Currently the IRS Code allows any unused portion of a gift to be carried forward for five years in addition to the year of the gift.

3. An increase from 60% to 70% in the capital gain deduction for sales of conservation lands for conservation purposes.

4. A credit against estate tax liability for estate contributions of conservation lands to the appropriate United States agency.

5. An estate tax deduction for the carry-over of unused lifetime contributions of conservation lands.

6. The allowance of the nonrecognition (or rollover) of taxable gain for sales of conservation lands, provided that the proceeds of such sales are reinvested within a three-year period.

7. The allowance of a deduction for a contribution of land when the taxpayer is reserving subsurface minerals and the right of access to such minerals.

We believe that these amendments to the IRS Code are strong incentives and will successfully spur a much needed increase in conservation donations. We believe that the final version of this legislation, at a minimum, should include all of the above provisions. While each provision separately will contribute to the likelihood of more conservation donations, the strength of S. 1675 is in pooling these provisions.

We applaud the efforts of Senator Wallop and this Committee. We realize that amending the IRS Code is no small matter and that, in this day and age, this bill could potentially be perceived as a drain on revenue. However, if the private sector is going to fill the gaps left by government cutbacks, then it must be provided with the tools do the job. We firmly believe, and I cannot say this strongly enough, that the issue of natural diversity preservation is a highly significant priority for this country and that public policy should encourage conservation wherever possible. Although I have stated that we employ fee acquisition most frequently in land preservation, let me repeat that we do not believe that purchase alone will be sufficient to do the job that needs to be done. I urge you to give us, and other conservationists, the tools to do the job. We are racing against time, and need all the help we can get. Let me close by remembering words that, I believe, must guide us in this issue:

> "We do not inherit the land from our grandparents; we are borrowing it from our grandchildren."

STATEMENT OF KINGSBURY BROWNE, GENERAL COUNSEL, LAND TRUST EXCHANGE, MOUNT DESERT, MAINE

Mr. BROWNE. Senator Wallop, I'm Kingsbury Browne. I'm a partner in the Boston law firm of Hill & Barlow. I would like to "record," if that is the correct word, the interest of five land trusts in New England of these proceedings, in your bill. We are very appreciative of the effort of staff and this committee that has been put into this project. Those organizations are the Main Coast Heritage Trust, whose activities include a very successful easement program involving, for example, 83 islands adjacent to Arcadia National Park; the Society for the Protection of the New Hampshire Forest, organized in 1901; Trustees of Reservations in Massachusetts, organized in 1891; the Ottakeeche Land Trust of Vermont; and the Western Pennsylvania Conservancy, which is the leading conservancy in western Pennsylvania.

Senator WALLOP. Could I just interrupt? It would be very helpful if—you have just banged a number of Senators—it would be very helpful if you could persuade them of your interest. And we need some more cosponsors.

Mr. BROWNE. Yes, sir.

I think the community was caught a little short from the time point of view.

Senator WALLOP. I understand that.

Mr. BROWNE. I think others will respond.

I am not here in a representative capacity. I am general counsel to the Land Trust Exchange, which is now headquartered in Maine, but is a national organization owned and operated, if you will, by local land trusts.

My expertise is in the tax field. I'm not a land use specialist so my usefulness, if there is any, is to look at the various incentives in your bill from the point of view of tax policy. I will try to do so perhaps less rigidly than Treasury, but still there are conflicting policies between environmental concerns on the one hand and tax policy concerns on the other.

Some of your incentives, I think, fall within given adopted policy guidelines. And, therefore, one would think that they should be adopted, that no great accommodation is called for on the part of Treasury. Others, however, do represent radical departures from existing tax policy, and all that means, it seems to me, is that the case to be made by the land trust community must be a very strong one.

I think Mr. Reilly was really addressing that when he talked about the need for inventories and base line data. Some of these departures are quite radical from the point of view of tax policy people. But if one were to put into a category those incentives which seem to fall within existing tax policy parameter, I certainly would begin with the unlimited carryover provision. We are now limited to 5 years of unused charitable deductions. I think the trend elsewhere in the Internal Revenue Code is to favor unlimited deductions—carryovers of deduction. For example, the capital loss carryover is now unlimited in point of time.

The rollover of gain provision. There are some policy considerations there. But in Massachusetts, for example, the Commonwealth has a funded program for the purchase of development rights from farmers, the affect of which is to extinguish development on farm land. The astute farmer will say to the Commonwealth as it offers to buy in the development rights, I do not want cash because that will create a taxable transaction, but go buy me a piece of land, and the transaction will be tax free. That puts a great deal of emphasis on the skill of counsel. Your provision would eliminate that.

The safe harbor provision I will not comment on. I think that's within—I don't think that's a radical departure from tax policy, but I think it must be done as a matter of statute.

The difficult ones, I think, are the increase from 30 to 50 percent in the deduction. I think Treasury, with some basis, says a gift of appreciated property escapes capital gains taxation. So the 30 to a 50 is a sort of a quid pro quo. And, therefore, a strong case needs to be made for it.

The estate tax credit I found to be a very imaginative, provocative one. Many problems in it. I would suggest that a dollar for dollar approach is a little rich. That we have always been able to say with income tax deductions, the American people are buying conservation land at a bargain because they are getting paid 50 cents on a dollar through the tax system.

Later, if I could come back to it, I would like to suggest——

Senator WALLOP. We have, I think, time. And I would just as soon you go through your provisions.

Mr. BROWNE. All right, sir. Thank you.

We have always been able to say in response to Treasury objections that the tax incentives never fully compensated the landowners. That is, assuming fair valuation. The American people through the tax shelter restore only 50 percent of the value of the property given. So it's a bargain purchase. It's an obvious advantage to the American people. It's also a restraint which may be needed in this area.

So the dollar for dollar credit in the estate tax areas seem to me to be going pretty far in that it eliminates that essential bargain element which has been pretty successful today. Again, I think that's a case that has to be made by the land trust community.

The other item that would be extremely helpful, if it could be added to your legislation—and I know nothing of procedure—would be to uncouple the gift and estate tax provisions from the income tax provisions that relate to the deductibility of charitable gifts of conservation easements. I think, as you know, we are having a great deal of difficulty with Treasury workings toward practical regulations to interpret, to provide guidelines under the 1981 act. The real stickler at times that I see around the country is the threat of a gift tax if there is a failure to meet the very elaborate test of the 1980 act. It's the gift tax. A very valuable easement of, say, $1 million. The threat of a gift tax may be very remote, but the amount involved is staggering, $300,000 or $400,000. And many of us believe that the policies that lie behind the 1980 income tax deduction limitations for conservation purposes really do not apply in the transfer area and that we could move ahead quite a lot more rapidly than we are now if that could be introduced now or at some later date.

Thank you, sir.

Senator **Wallop**. We will certainly look at that. We can do almost anything with the legislation. I'm not sure we can pass almost anything But we can certainly make an effort.

[The prepared statement of Mr. Browne follows:]

HILL
&
BARLOW

Committee on Finance
Subcommittee on Energy & Agricultural Taxation
February 6, 1984 Hearings on S.1675

Statement of Kingsbury Browne

My name is Kingsbury Browne. I am the senior partner of the Boston law firm of Hill & Barlow and a specialist in Federal tax law. While I do counsel many landowners and Land Trusts, I am here today expressing my own opinions. Since my expertise is not in land-use matters, I propose to limit my comments to an assessment of the tax policy changes incident to the adoption of the various tax incentives in S.1675. Enactment of the suggested tax incentives will require the Congress to accommodate conflicting Federal tax and environmental policies. To the extent that a proposed incentive involves a radical departure from existing Federal policy, the case for the environmental objective involved must be a strong one. Some, however, of the tax incentives in S.1675 are reasonably consistent with existing Federal tax policy so the degree of accommodation is slight.

I.

INCENTIVES CONSISTENT WITH EXISTING FEDERAL TAX POLICY

Unlimited Carryover of Unused Charitable Deduction [Section 2(a)]

The administrative problems attendant upon substituting an unlimited carryover for the present five-year period seem to be minor in terms of the environmental objectives involved. Carryovers soften the arbitrary features of the annual accounting period and reduce discrimination among large and small taxpayers. There is an unlimited carryover for net capital losses realized by an individual and Congress recently increased the carryover period for net operating losses from five to fifteen years.

A substantial part of this statement is taken from a memorandum prepared by me on August 22, 1983 and distributed by the Land Trust Exchange which was created in 1982 by the Land Trust Community to serve as a vehicle of communication, assistance, and interchange in private land conservation.

Rollover of Gain -- Reinvestment and Nonrecognition of Gain (Section 6)

The Commonwealth of Massachusetts has a State program for the purchase of what are called Agricultural Preservation Rights (APRs) from farmers. An APR represents the development rights which when purchased by the State at fair market value are extinguished leaving the landowner unable to develop the land but free to continue to farm it or use it for any other purpose besides development. To the extent that gain is realized there is presently a taxable transaction. S.1675 would ameliorate that situation by deferring the recognition of any such gain if within three years after the close of the taxable year in which the purchase of the APRs occurred the landowner purchases any real property interest and thereafter continues to hold it for investment. Reinvestment need not be in the farm, itself, but must be in real estate. This provision with some modification codifies the result that astute landowners can achieve under current law. Thus, a Massachusetts farmer may refuse a cash offer by the Commonwealth but offer to trade APRs for an interest in real estate to be purchased by the Commonwealth for purposes of the trade. Even if the Commonwealth were in a position to accommodate landowners in that manner (which it is not but some states such as California may be), most landowners simply do not have access to the sophisticated counseling needed to enable them to achieve that result. The proposed statutory change does expand upon existing tax policy in that it would accord like-kind nonrecognition treatment to a cash transaction. On the other hand, it is consistent with the tax policy of §1039 which allows nonrecognition in a cash transaction provided the cash is reinvested in narrowly defined like-kind property. (Section 1039 involves low income housing). To be consistent with tax policy it would seem that the provisions of S.1675 should be amended to require reinvestment in farm-related real estate of a business or investment nature.

Safe Harbor for Conservation Easements [Section 2(b)]

S.1675 introduces a safe harbor for charitable gifts of conservation easements and similar qualifying partial interests given to governmental entities. The Proposed Regulations under §170(h) indicate that acceptance of an easement by a governmental entity "tends" to meet the statutory requirement that the gift be pursuant to clearly delineated governmental conservation policy. There is widespread criticism of the failure of the 1980 statute and the Proposed Regulations to make acceptance by a governmental entity dispositive of the clearly delineated test. As a matter of Federal tax policy, the objection to safe harbors arises out of concern with the expenditure of revenue outside of the budget process. The argument that one hears is that even a governmental agency such as the National Park Service will not exercise the same degree of caution when it accepts the gift of a conservation easement that it would were it purchasing that easement with funds from the Department budget. In both situations Federal funds are involved either directly through the budget process or indirectly through tax incentives. The Internal Revenue Code contains several safe harbors so the one proposed in S.1675 has precedent.

In my own opinion the tax policy argument in opposition to the safe harbor is a weak one because it overlooks the two primary restraints involved in easement transactions. First, the tax incentive provides only partial compensation for the gift -- the accepting agency is making a bargain purchase. Second, the gift imposes obligations on the recipient to monitor and enforce the restrictions involved. The safe harbor should be broadened, however, to cover also those jurisdictions where easements require prior governmental approval if not governmental acceptance. In the Commonwealth of Massachusetts, for example, easements must have the approval of the local Board of Selectmen as well as the State Secretary for Environmental Affairs notwithstanding their acceptance by private charitable organizations. There is no basis for distinguishing the program in Massachusetts from those in the Commonwealth of Virginia and the State of Maryland. In the case of this and other incentives it would be appropriate to consider a five-year sunset date so as to establish a trial period during which to evaluate the soundness of the incentive.

II.

INCENTIVES INVOLVING SUBSTANTIAL DEPARTURE FROM PRESENT FEDERAL TAX POLICY

Increase in 30 Percent Income Tax Deduction Ceiling to 50 Percent [Section 2(a)]

Adoption of the proposed increase of the 30 percent ceiling to 50 percent will involve a radical departure from existing tax policy. Present law represents a 1969 Congressional decision to prevent a taxpayer from counting appreciated property in full for charitable deduction purposes and at the same time permitting unrealized appreciation to escape capital gains tax. The cut of the 50 percent ceiling applicable in the case of cash gifts to 30 percent in the case of gifts of appreciated property was a sort of quid pro quo for the loss of tax on unrealized gain. Given the tax policy change involved, the Land Trust Community must make a very persuasive case and also anticipate the insistence of other exempt organizations for similar treatment. The revenue cost of such an expanded provision may well be unacceptable in the current budget situation. This revenue cost could be cut, for example, by allowing the transfer to qualify for the 50 percent benefit on the condition that 40 percent of the unrealized gain were included in income as capital gain.

Death and Unused Charitable Deduction Carryovers (Section 5)

The amendment proposed to permit the unlimited carryover of unused charitable deductions is of no help in the case of untimely death. Section 5 of S.1675 would alow a decedent's estate a charitable deduction for estate tax purposes to the extent the decedent died with unused income tax charitable deduction carryovers. This proposal would represent a radical change in existing law. For gift tax purposes the decedent would have already taken a full gift tax charitable deduction. To allow a further deduction at death would in effect allow a double deduction for the same gift for wealth transfer tax purposes. The argument advanced by Land Trusts is that the charitable deduction for income tax purposes reduces a contributing landowner's income tax burden. It has a shelter effect, but only if a landowner has otherwise taxable income. Many ranchers, among others, are not in that position so a charitable gift is of no immediate income tax benefit. The unlimited carryover provision may be of some eventual help by permitting a carryover to a subsequent year when the landowner's taxable income picture may have improved but even that advantage is denied if the landowner dies prematurely. By converting the unused income ~~for~~ tax charitable deduction carryover into an estate tax charitable deduction, the accident of death becomes irrelevant and some benefit is salvaged. Federal tax policy, however, has not favored deductions surviving death (except in the narrow area of income with respect to a decedent (see section 691), so adoption of the incentive will require substantial accommodation of existing Federal tax policy to environmental concerns. An alternative to this rather complex incentive might be to allow an unlimited charitable income tax deduction in the year of the decedent's death.

The Estate Tax Credit (Section 2016)

S.1675 would allow an estate tax credit for the fair market value of certain testamentary gifts to the United States of interests in real property such as conservation easements. The credit mechanism in lieu of the deduction presently allowed eliminates differences in tax benefit attributable to differences in rate bracket. As drafted the proposed incentive would provide far more relief than the present deduction apparently in an effort to give the decedent some of the greater tax benefit that would have been enjoyed had the decedent made the gift during lifetime and taken a charitable deduction for income tax purposes. The basic tax policy question is whether it is sound to put Treasury in the land acquisition business through the Federal estate tax system. Treasury is already in that business to the extent that it offers an income tax subsidy for charitable gifts of conservation easements. The shelter offered through the income tax system is deficient to the extent the shelter or subsidy turns on the existence of otherwise taxable income in the landowner. The estate tax credit would tend to correct that deficiency but it would discourage inter vivos gifts of easements. The estate tax credit makes some sense in terms of correcting inequities in present tax policy, but only if the credit is for some amount substantially less than the fair market value of the donated property so as to bring it in line with the present scale of income and estate tax benefits. One of the strongest arguments for retaining the present charitable income tax deduction and complementing it with an estate tax credit is the bargain purchase effect that it produces: the recipient governmental entity acquires on behalf of the public a conservation easement at a price far below its fair market value. One dollar of public funds may purchase $2 worth of conservation property. The bargain element acts as a substantial restraint on loss of revenue.

The Proposed estate tax credit incentive is imaginative but its adoption will involve a radical departure from existing Federal tax policy and considerable complexity. Further study perhaps by Treasury and Joint Committee Staffs may be desirable.

Capital Gains Tax Rate Reduction (Section 7)

The provision in S.1675 that would reduce the maximum capital gains tax rate from 20 to 15 percent in cases of sales of conservation easements and similar partial interests is an expanded tax benefit that will be demanded by all charitable purchasers of property. It favors one market over another and will therefore encounter resistence from developers and other buyers competing for land. The provision would indirectly provide the Land Trust Community with additional funds to acquire conservation real estate interests since its effect is to reduce the capital gains tax otherwise payable by sellers. The Land Trust Community will have to establish a strong case for such preferential treatment given the strength of the opposing Federal tax policies.

III.

ADDITIONAL INCENTIVES

Conservation Easements -- Uncoupling of Gift and Estate Tax Provisions

Present law provides that charitable transfers of partial interests such as conservation easements will be subject to gift and estate tax if the transfer fails to meet the conservation purposes tests of §170(h). The general impression is that charitable transfers are not subject to gift tax and while that is true in most cases, the favorable result is achieved only through the allowance of a charitable deduction. When the Congress in 1980 introduced the conservation purposes limitation in §170(h) for income tax deduction purposes, it also incorporated those same limitations into the charitable deduction allowed for gift and estate tax purposes. The present conservation purposes tests involve a high degree of judgment (what is scenic, for example) and the threat of possible gift tax in the event of failure to meet one or more of the judgmental standards has materially restrained promising conservation easement programs. Some of the tax policy considerations behind the adoption of the conservation purpose limitations for income tax purposes have no relevance in the gift and estate tax areas. The elimination of the technical income tax limitations insofar as gift and estate tax charitable deductions are concerned is referred to as the so-called uncoupling of the transfer taxes from the income tax. Such uncoupling would not seem to involve any significant change in present Federal tax policy. It is widely believed that such uncoupling would tend to restore the vitality of many existing easement programs.

Respectfully submitted,

Kingsbury Browne

Kingsbury Browne

STATEMENT OF EDWARD THOMPSON, JR., COUNSEL, AMERICAN FARMLAND TRUST, WASHINGTON, D.C.

Senator WALLOP. Mr. Thompson.

Mr. THOMPSON. Good morning, Senator. For the record, I'm Ed Thompson, counsel of the American Farmland Trust. AFT is the only national, private nonprofit group that deals exclusively with conserving land for agricultural purposes. And on behalf of AFT, I thank you for the opportunity to be here. We, too, participated in the workshops that you held, Senator. And I would like to add our voice to those of the other panelists in congratulating you for your leadership in this area. It is truly extraordinary. And because our group believes in both public and private solutions to conserving the land resources of the country, we, too, favor expanding the options and getting all those tools on the table, as Greg suggested earlier. So we appreciate the truly creative thought that has gone into this bill and its recognition that the range of options should be broadened.

We enthusiastically support S. 1675 because of this expansion. Its mix of tax incentives, in our opinion, are well thought out and balanced. It removes some, if not all, of the obstacles that today face private conservation because of uncertainty over how the current tax laws will ultimately be interpreted.

And, last, it moves us in the right direction of putting conservation on a more even footing with other social goals that we promote through tax policy. And we feel that is very important.

I would like to discuss a few possible revisions in the bill that in our judgment would make it stronger. We regard most of these as fairly routine. The section that would allow contributions made to governmental agencies automatically to qualify, we feel might be broadened by providing a similar automatic qualification for certification by Government agencies. As a practical matter, there doesn't seem to be much difference between certification by and actual receipt of, say, a conservation easement by an agency. The only difference would be the responsibility and cost of monitoring those restrictions. And I would suggest to you that the public would pay less for that monitoring enforcement if private organizations were the ones that held the easement.

Moreover, many people just don't want to deal with Government agencies. We have dealt with many farmers who simply would not consider giving an easement to a governmental agency, whereas they would, indeed, trust private organizations. So again the distinction there is important.

There is precedent in the National Register for some kind of certification procedure. And we think that it's not such a radical departure that it couldn't be incorporated here. It would help eliminate some of the great uncertainty that does exist today in this area of easements that, in our judgment, is having a chilling affect on contributions.

Second, your estate tax credit, which we would favor, is limited to contributions to the Federal Government. And I, frankly, am not sure that I see a distinction between the Federal Government and other governments or, indeed, between the governments and the private sector organizations. I've read your statement in the Congressional Record, and if it's a question of making other options relatively more attractive, I think you could go so far as to make the credit comprehensive in order to avoid having landowners postpone contributions until death. That is to say, make the credit apply against income, gift and estate taxes. That may be a fairly substantial departure, but that would go far toward recognizing that conservation might be put on a more even footing with more consumptive uses of land.

Finally, in the provision that would alter the capital gains treatment of conservation sales, we wonder whether you might not consider eliminating the reinvestment provision. This is not a situation like forced sale or condemnation or a tax free exchange where the taxation is merely postponed and the rationale is that the investment is simply being continued. Here the tax would be excused. And we are not sure we see a social purpose that would be served by requiring that the proceeds of the sale of conservation property be reinvested in other property within 3 years. It might just tie up capital in land that might better be put in farm equipment, for example, to improve productivity. You might consider eliminating that.

In the case where the State is, for example, the purchaser of a conservation property, I think to require a reinvestment dilutes the principle, which we believe in that the Federal Government ought not to be taxing the State efforts to conserve land, which is one way of looking at this provision.

While I am on the subject of capital gains, I would like to make one observation here. I understand that there are a number of proposals floating around Washington to increase the holding period from 1 to 5 years, and although conservationists are certainly not the only people who are interested in that provision, I would like to point out that that would be likely to have a serious affect on any of the provisions dealing with conservation property here by chilling it.

Senator **Wallop**. It would have an affect on quite a few things.

Mr. **Thompson**. Indeed. So I would like to conclude again by reiterating the principle that in this country, it seems to me, we have been for years fairly extravagant with our tax policy when it comes to promoting consumptive uses of land resources in particular. But we have been very parsimonious, I think, to say the least when it comes to promoting conservative uses of land. And we see this bill as a very positive step in the right direction of bringing back some balance in that relationship.

We thank you very much for introducing it, and pledge our support to it.

Senator **Wallop**. Thank you, Mr. Thompson.

[The prepared statement of Mr. Thompson follows:]

TESTIMONY OF EDWARD THOMPSON, JR.
COUNSEL, AMERICAN FARMLAND TRUST
BEFORE THE SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION
OF THE U.S. SENATE FINANCE COMMITTEE
ON S. 1675
PUBLIC LANDS ACQUISITION ALTERNATIVES ACT
FEBRUARY 6, 1984

GOOD MORNING, MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE. I AM EDWARD THOMPSON, JR., COUNSEL TO THE AMERICAN FARMLAND TRUST, A NATIONAL PRIVATE NONPROFIT ORGANIZATION COMMITTED TO THE CONSERVATION OF AGRICULTURAL LAND RESOURCES. I THANK YOU FOR THE OPPORTUNITY TO TESTIFY TODAY.

BY WAY OF FURTHER INTRODUCTION, I WANT TO OFFER OUR APPRECIATION AND CONGRATULATIONS TO SENATOR WALLOP, SPONSOR OF S. 1675, FOR HIS LEADERSHIP IN PROMOTING PRIVATE SECTOR CONSERVATION AS AN ALTERNATIVE TO PUBLIC LAND ACQUISITION. CONSISTENT WITH ITS "MIDDLEGROUND" PHILOSOPHY, AFT BELIEVES THAT THERE IS AN IMPORTANT ROLE FOR BOTH PUBLIC AND PRIVATE INITIATIVES IN CONSERVING AMERICA'S IRREPLACEABLE AND FAST-DIMINISHING AGRICULTURAL LAND RESOURCES. THUS, WE WELCOME THE EXPANSION OF PRIVATE CONSERVATION OPTIONS THROUGH PUBLIC TAX POLICY THAT S. 1675 WOULD ACHIEVE.

AFT ENTHUSIASTICALLY ENDORSES THE BILL, WHICH OFFERS A BALANCED MIX OF TAX INCENTIVES TO PRIVATE LANDOWNERS TO ENCOURAGE THEM TO CONSERVE IMPORTANT LANDS. IT WOULD ALSO REMOVE SOME OF THE OBSTACLES PRIVATE CONSERVATIONISTS NOW FACE BECAUSE OF LINGERING UNCERTAINTY OVER HOW THE CURRENT TAX LAW WILL ULTIMATELY BE INTERPRETED. AND S. 1675 MOVES US IN THE RIGHT DIRECTION, I THINK, OF PUTTING CONSERVATIVE USES OF LAND ON A MORE EQUAL FOOTING WITH CONSUMPTIVE USES WHEN IT COMES TO ENCOURAGEMENT THROUGH FEDERAL TAX POLICY.

OF ALL THE PROVISIONS OF THE BILL, THOSE IN SECTION 2 ARE IN OUR VIEW THE MOST IMPORTANT. ON ONE HAND, THEY WOULD MAKE PRIVATE LAND CONSERVATION A MORE REALISTIC OPTION FOR LOW AND MODERATE INCOME FARMERS AND RANCHERS, MAKING THE ENTIRE REALM OF CONSERVATION MORE EQUITABLE. ON THE OTHER, THEY WOULD HELP ELIMINATE THE UNCERTAINTY OVER WHICH TYPES OF CONSERVATION LANDS QUALIFY FOR FAVORABLE TAX TREATMENT, THUS CONTRIBUTING TO THE PREDICTABILITY THAT IS ESSENTIAL TO THE ULTIMATE SUCCESS OF ANY PRIVATE CONSERVATION VENTURE. IF EVERYTHING ELSE WERE TO FAIL, THESE ARE THE PROVISIONS WE WOULD WISH TO SEE ENACTED.

WHILE ENDORSING THESE AND OTHER PROVISIONS OF S. 1675, I WOULD LIKE TO OFFER A FEW SUGGESTIONS FOR REVISION THAT COULD IMPROVE THE OVERALL PACKAGE. NONE OF THESE WOULD APPEAR TO HAVE SIGNIFICANT REVENUE IMPLICATIONS.

FIRST, CONSIDER REVISING SECTION 2 TO PERMIT CONTRIBUTIONS AUTOMATICALLY TO MEET THE SECTION 170(H) CONSERVATION PURPOSE TEST, NOT ONLY IF THE PROPERTY IS CONTRIBUTED TO A GOVERNMENTAL AGENCY, BUT ALSO IF SUCH AN AGENCY WITH CONSERVATION JURISDICTION CERTIFIES THAT THE CONTRIBUTION WOULD SERVE A BONA FIDE CONSERVATION PURPOSE. BOTH ACCEPTANCE BY A PUBLIC AGENCY AND CERTIFICATION BY SUCH AN AGENCY WOULD EQUALLY ASSURE THAT THE LAND IN QUESTION MERITS CONSERVATION. AS A PRACTICAL MATTER, THE ONLY DIFFERENCE BETWEEN AN EASEMENT HELD BY A PUBLIC AGENCY AND ONE HELD BY A PRIVATE CONSERVATION ORGANIZATION (AND CERTIFIED AS SUGGESTED) IS THAT IN THE FIRST CASE THE PUBLIC BEARS THE CONTINUING COST AND RESPONSIBILITY OF MONITORING AND ENFORCEMENT. THIS, COUPLED WITH THE FACT THAT A SIGNIFICANT NUMBER OF FARMERS AND RANCHERS SIMPLY DO NOT WISH TO ENTRUST THE GOVERNMENT WITH THE RESPONSIBILITY OF ENFORCING DEED RESTRICTIONS, BESPEAKS OF A NEED TO EXTEND THE OPTION OF AUTOMATIC QUALIFICATION TO CONTRIBUTIONS CERTIFIED BY A COMPETENT GOVERNMENT AGENCY, AS WELL AS THOSE ACCEPTED BY SUCH AGENCY.

SECOND, CONSIDER EXTENDING THE PROPOSED ESTATE TAX CREDIT IN SECTION 4, NOT ONLY TO CONTRIBUTIONS TO THE FEDERAL GOVERNMENT, BUT ALSO TO THOSE TO OTHER GOVERNMENTAL AGENCIES AND QUALIFIED PRIVATE CONSERVATION ORGANIZATIONS. THE RATIONALE HERE IS MUCH THE SAME AS FOR THE PREVIOUSLY SUGGESTED REVISION. HOWEVER, SOME HAVE EXPRESSED CONCERN THAT SO GENEROUS AN INCENTIVE TO CONSERVATION BEQUESTS MIGHT DISCOURAGE OR POSTPONE INTER VIVOS CONTRIBUTIONS. I WOULD NOTE IN RESPONSE THAT UNDER THE CURRENT TAX LAWS, VERY FEW ESTATES ACTUALLY INCUR TAX LIABILITY, SO THAT THE PROPOSED ESTATE TAX CREDIT, EVEN IF MODIFIED AS I HAVE SUGGESTED, STILL WOULD PROBABLY NOT BE AS MUCH AS INCENTIVE TO THE AVERAGE FARMER OR RANCHER AS THE INCOME TAX DEDUCTION IN SECTION 2 OF THE BILL. (IF CONCERN PERSISTS, CONSIDER MAKING THE TAX CREDIT APPLY COMPREHENSIVELY AGAINST FEDERAL INCOME, ESTATE AND GIFT TAXES, POSSIBLY WITH AN UPPER LIMIT ON THE INCOME SIDE BASED ON NET WORTH AS A PROXY FOR THE LIKELY VALUE OF THE TAXPAYER'S ESTATE. THIS WOULD ACCELERATE THE BENEFIT TO THE TAXPAYER WITHOUT ADDITIONAL REVENUE IMPLICATIONS.)

THIRD, CONSIDER ELIMINATING THE REQUIREMENT IN SECTION 6 THAT THE PROCEEDS OF A SALE OF CONSERVATION PROPERTY BE RE-INVESTED TO QUALIFY FOR NONRECOGNITION AS CAPITAL GAIN. UNLIKE THE EXCHANGE AND CONDEMNATION PROVISIONS OF THE CODE, WHICH POSTPONE TAXATION IF RE-INVESTMENT OCCURS, THE INTENT HERE SEEMS TO BE TO EXCUSE TAXATION IN SUCH EVENT. IF THAT IS THE CASE, THE QUESTION ARISE AS TO WHAT PURPOSE IS SERVED BY RE-INVESTMENT? I WOULD NOTE THAT THIS REQUIREMENT MAY TIE THE HANDS OF MANY FARMERS AND RANCHERS WHO MIGHT FIND IT MORE WORTHWHILE TO RE-INVEST THEIR PROCEEDS IN EQUIPMENT OR OTHER ITEMS TO IMPROVE YIELDS OR SAVE TOPSOIL. REQUIRING REINVESTMENT IN REAL PROPERTY MIGHT JUST TIE UP CAPITAL NEEDED FOR OTHER PURPOSES. (COMPARE H.R. 2119, SPONSORED BY REP. BYRON, WHICH PARALLELS SECTION 6 BUT WOULD ALLOW RE-INVESTMENT IN "QUALIFIED FARM PROPERTY," INCLUDING ANY CAPITAL ITEM.)

THERE IS ALSO A MATTER OF PRINCIPLE INVOLVED WITH THE RE-INVESTMENT PROVISION OF SECTION 6. THE PRINCIPLE IS THAT THE FEDERAL GOVERNMENT OUGHT NOT TO TAX STATE CONSERVATION EFFORTS, ESPECIALLY WHERE NO APPARENT PURPOSE IS SERVED. REQUIRING RE-INVESTMENT OF THE PROCEEDS OF A SALE OF CONSERVATION PROPERTY TO A STATE, DILUTES THIS PRINCIPLE. WHERE THE LANDOWNER HAS NO REASON TO RE-INVEST, THE COST TO THE STATE TAXPAYERS OF ACQUIRING CONSERVATION PROPERTY INCREASES. ONE CAN ARGUE THAT THIS SAVES THE FEDERAL TREASURY, BUT I ASSURE YOU, AS ONE WHO PAYS TRIBUTE TO BOTH WASHINGTON AND ANNAPOLIS, THAT IT COMES OUT OF ONE POCKET OR ANOTHER.

LET ME CONCLUDE BY AMLIFYING ONE OF MY EARLIER REMARKS ABOUT THE OBJECTIVES S. 1675 WILL SERVE. ONE OF THESE IS HELPING PUT CONSERVATIVE USES OF LAND ON A MORE EQUAL FOOTING WITH CONSUMPTIVE USES. IN MY OPINION, OUR TAX POLICY HAS BEEN RATHER EXTRAVAGANT IN GRANTING CONCESSIONS TO THOSE WHO MOVE EARTH, BUT PARSIMONIOUS IN AFFORDING EQUIVALENT TREATMENT TO THOSE WHO WANT TO SAVE IT. UNLESS WE WISH TO RELY EXCLUSIVELY ON GOVERNMENT TO DO THE JOB, I THINK WE ARE GOING TO HAVE TO PROVIDE MUCH GREATER INCENTIVES TO PRIVATE CONSERVATION. INCENTIVES PERHAPS AS SIGNIFICANT AS THE INVESTMENT TAX CREDIT. WE ARE GOING TO HAVE TO GO BEYOND TRYING TO STIMULATE CHARITABLE INITIATIVES. TO OVERCOME THE MINDSET THAT IT IS FINE TO MAKE A BUCK -- EVEN A LOT OF MONEY -- CONSUMING RESOURCES, BUT SOMEHOW ABUSIVE TO MAKE MONEY BY CONSERVING THEM FOR FUTURE GENERATIONS TO USE. IN SHORT, WE ARE GOING TO HAVE TO GET CONSERVATION DOWN TO BUSINESS. S. 1675 REPRESENTS ANOTHER MODEST AND WELCOME STEP IN THAT DIRECTION.

THANK YOU.

Senator WALLOP. Generally addressing a thought to the panel, and anybody can respond to it, I think it was you, Greg, who suggested that the provision that Mr. Browne thought might be worrisome of the increase from 30 to 50 percent was the one that made it possible for the small landholder, small income landholder, to qualify. Let me ask the tax experts on the panel if it might be possible to develop a sliding scale on that so that you did qualify those people who had relatively major incomes in terms of the value of their holdings, to induce them to make this move, if it were to be identified as in the national interest. Is that a possibility?

Mr. BROWNE. I think it is a possibility. It's a reflection of the fundamental difficulty that we have with a graduated income tax. That people on the low side are not getting the shelter that the people on the up side are getting. I have not tried to think through the graduated scale notion. Another way to look at it is to convert the deduction into a credit so that this element of chance of the bracket that you are in is eliminated through a credit mechanism, so I think there is a great deal to be said in one way or the other of getting at this difficulty.

Senator WALLOP. That's a thought that might be worth pursuing. The other thing—and I would just put it out to you, Bill or anybody—is to address Mr. Browne's concern about the dollar for dollar being a little bit rich. And I understand that from a tax policy standpoint. But from land acquisition standpoint, or value acquisition standpoint I think you may still be getting more than a dollar for dollar benefit out of it in terms of the alternative of Government fee acquisition of the same piece of property. I wonder if you might comment from experience or otherwise on this.

Mr. REILLY. Well, in your introductory remarks you commented on the situation in the Santa Monica National Recreation Area. There are many others as well, as you know in the national parks where there is substantial inholdings in areas authorized for purchase by the Federal Government. And I don't know what the dollar value of the backlog is. People have talked to three or more billion dollars in the backlog of lands authorized for purchase in those boundaries It's going to be very difficult to make many of those parks workable, integral units, functioning units, and prevent the kinds of threat that alternative developments incompatible with their own conservation present. And by the same token, as you also noted, it's difficult to justify leaving the owners of those properties in limbo indefinitely without having any development expectations they can realize.

It seems to me this is a very reasonable way to accommodate both the national interest and the fairness issue as far as those taxpayers are concerned. And you might think in turns, if the tax community concludes that it is a bit rich to have a dollar for dollar equivalency, to limit that particularly rich portion, the tax credit portion, to areas of national significance, and particularly high priorities such as the national parks represent.

Senator WALLOP. Those that have already been identified?

Mr. REILLY. That's right. That have gone through a torturous process and been determined to be very significant and distinguished and already exist as national park units. It would take a long time to even run through them, and accomplish the blocking up of those inholdings.

That has been an issue, as you know. When we have had instances where sites have come available within the national parks and because the tax people have insisted upon the payment in cash rather than in the land or in the conservation value of their properties, properties have had to be sold off; they have typically been subdivided which has inflated the value, and very often the Federal agencies, the park service and others, have concluded, well, we will not table them for high priority acquisition because their value has gone through the roof and have looked elsewhere. This, it seems to me, is a very reasonable way to meet that problem.

Mr. THOMPSON. Senator, if I could add to that.

Senator WALLOP. Yes.

Mr. THOMPSON. This is getting into the area that is dearest to my heart as a conservationist. And the issue is really how much value do we place on these land resources, these capital assets of the country that are going to benefit us for time immemorial if we can preserve them. I don't think it's rich to suggest that a dollar for dollar exchange is too much to offer in this area. We offer dollar for dollar exchanges in many other areas of seeking social objectives. And investment tax credits come to mind where we are trying to stimulate capital investment in various kinds of enterprises. Well, here we are trying to save natural capital. And I think as conservationists as well as fiscally responsible people we should take a look and reexamine this relationship.

Senator WALLOP. I think what is needed here and what the conservation community is going to have to help me do is to separate in the public's mind the idea that somebody wealthy might be getting a break from the fact that the country is getting something that it can't get otherwise. The real key to this thing and the real persuasive argument that might exist is that these are things which are in the national interest. If that happens to fall in the lap of somebody that you rather it didn't, it doesn't diminish the fact of the interest. It may diminish the fact of your enthusiasm for that individual or that corporation or that entity. But it certainly doesn't diminish the fact of what the country may be getting. And that's difficult in these times. And that's really the argument. Examples exist in every State, fairly recently in mine, of people who are perhaps not the most attractive in the national news holding something that is very attractive in the national interest, and dealing with it as they wish and not as the interest would demand. I think particularly of the antelope situation in my State.

That's going to be the argument that everybody has to make. Keep your eye really on the specific issue and not get—by a variety of other distractions that might be running around on the outside edge of it.

Something comes to mind that is only vaguely related to this, but it is related to tax policy and conservation. Many of you that worked in these workshops and other things know that my father died just after I came to this Senate, and we have been working on that estate. And now I found that having given a rather large conservation easement to the Nature Conservancy, we still have a significant tax obligation to satisfy. And as you satisfy that with sales of other property, you find that you also have to satisfy the capital gains on the sales and it's a sort of wildly escalating thing that is causing me fits. And not a small amount of anguish. Not for the dollars, but for the amount of land that is extra that has to go into satisfying those obligations, which ultimately is at risk. Sooner or later somebody is going to use it for something other than the argicultural purpose that was there.

I appreciate your coming here. There was one last thing that I might ask you, Bill. If you would get with others in the tax area—you mentioned the occasional fleecing of that that the Government might take in the acquisition of some of these interests. And the harm that they do to the general good and purpose. Would you work with us to see if there was some way that we could find a penalty to attach to that because we now have the penalty problem that Mr. Browne identified—what happens if the gift tax provision suddenly is triggered. And that's the penalty that is sort of laid on people of goodwill. I would like to find a way to lay the penalty on people of ill will. So if all of you would kind of take a look at this and see if there isn't some way in which you might give us counsel in that area.

Mr. **Reilly**. We would be very pleased to do that, Senator. The issue is—I don't know how serious it is in the historic preservation field, but I can recall many years ago some of us were working with the Treasury Department to try to get both significant wetland areas and national properties of historic significance, buildings, protected, and especially recognized in the Tax Code. And finally we were unsuccessful with respect to wetlands because you couldn't clearly or we couldn't clearly identify precisely to the tax agent where their boundaries were. And that in the inventorying process proved to be key in terms of acceptance finally by the Treasury.

Well, you find that once you have a recognized inventorying system, the National Register of Historic Places, it becomes much, much easier, but you do get an enormous amount of pressure from landowners to try to get their property so recognized, if they have that tax interest. And that is worth thinking through in our field. We have not had the same kind of register. I think the work the Nature Conservancy has done in 20 some States has established the critical ecological areas for those states, and that would provide a real start. Certainly the national parks and already owned Federal properties, at a minimum, it seems to me, ought to be eligible for this kind of treatment.

But we will be happy to work with you and the staff to see if we can't think of how to prevent that problem arising or being serious.

Senator **Wallop**. Well, I appreciate it. And, Mr. Browne, if you would give us a little counsel on the gift tax problem.

Mr. **Browne**. I would be delighted to.

Senator **Wallop**. It would be very helpful to us too because it does seem a shame to put such an inhibition up there that somebody who otherwise would have a great deal of good will is terrified by the possibilities that might happen to him if the slightest glich in those proceedings was discovered at some later date. I don't think that's what we want to have happen.

Again, thank you all very much.

Senator WALLOP. The next panel consists of, first, a friend of mine and who has been interested in this a long time, Jean Hocker who is executive director of the Jackson Hole Land Trust in Jackson, Wyo.; Jan Konigsberg, land projects manager of the Montana Land Reliance, Helena, Mont.; Mr. Robert Dennis, executive director of the Piedmont Environmental Council, Warrenton, Va.; and a Mr. Mark Arth, Esq., from St. Paul, Minn. who is accompanied by James Cook, president of the Investment Rarities, Inc., in Bloomington, Minn.

And I have a statement by Senator Baucus which he would wish to have introduced into the record at the beginning of the proceedings.

Jean, please proceed.

STATEMENT OF MS. JEAN HOCKER, EXECUTIVE DIRECTOR, JACKSON HOLE LAND TRUST, JACKSON, WYO.

Ms. HOCKER. Good morning. I'm very happy to be here, and I do want to thank you, Senator, as everyone else is, for holding this hearing and for all the work you have done on focusing in on tools for land acquisition and land protection, including the two summer workshops that you held and the hearing that you held in Jackson Hole a couple of years ago. The Jackson Hole Land Trust holds conservation easements on seven properties now on over 2,100 acres, and I'm glad to report we have over 2,000 acres under consideration right now for easement projects.

I'm going to focus my remarks on tools that encourage gifts of interest in land and also on some of the clarifications of section 170(h), primarily because, in Jackson Hole, I don't think we are ever going to have the financial resources to make very many land purchases. And so we are in the business of encouraging gifts of land. And in that regard, I want to preface my remarks on tools for gifts by stressing what I know that you already know and that is, I don't know of any landowner who has given a conservation easement just because of the tax benefits that are involved. Certainly, in an area like Jackson Hole, where the development demand is high and land values are higher, no one makes money by giving away development rights. These kinds of gifts are made first because of a desire to protect the land. The tax benefits are a real incentive, there is no denying that, for those people who already want to protect the land. But they are definitely not part of any get-rich-quick schemes, opinions of some to the contrary. And the proposals in this bill won't really change that, I don't think, but they will add a number of incentives.

I agree with some of the people on the previous panel that, of all the provisions in this bill, the increase in the deduction ceiling from 30 to 50 percent and the unlimited carryover would probably have the greatest benefit to us and to the landowners and to the land we deal with. And that's not to diminish the importance of some of the rest of them.

Even people of very substantial means can't usually deduct the full value of, say, $1 million gift over a 6-year period, and those are the kinds of gifts, given the land values in Jackson Hole, that we are dealing with. Under current tax laws, a $1 million gift would require an adjusted gross income of about $500,000 a year annually to use up the entire value. That certainly eliminates the rancher whose only wealth is his land. And we do have a number of significant conservation properties still owned by decendants of early homesteaders. These are people who are wealthy on paper only.

I really don't think the national interest is served unless you protect the conservation properties, as you suggested, wherever they exist, and not just those owned by the very wealthy people, the ownership being much less relevant than the conservation values you are trying to protect. And these two provisions would help enormously—the unlimited carryover and the increase in deduction ceiling.

Likewise, the credit against estate taxes would encourage land protection by people of relatively modest income and would make unnecessary the sale of significant properties to pay estate taxes. You have asked whether this would decrease the incentive for giving during one's lifetime. I don't know. Probably in a few cases it would. But what I see this doing is really opening up the possibility of land conservation to people who don't now have that opportunity—that is, the beneficiaries and the executors of estates.

Senator **Wallop**. Let me just ask the other obvious question. Assuming that it does discourage gifts, during one's lifetime, as long as it encourages a gift, does it matter?

Ms. **Hocker**. That's the other side of the coin. As long as their gift is in a condition at the time of the death to meet the qualifications for conservation property, no, it doesn't matter whether it's this year or 25 years from now as long as it is ultimately protected. But what you do lose is the possibility—what you have, of course if you delay is the possibility that something or a decision would be made in the interim which would disqualify it eventually. So from that standpoint it might be a problem.

But I don't see it as having major significance in that regard. People who want income tax deductions and can use them will probably make lifetime gifts. Those who can't and the executors and heirs of those who haven't, will use this estate tax credit tool.

Like others, I would like to see the estate tax credit be available for gifts to private organizations as well as to the Federal Government. And in my written testimony I have questioned whether in fact there would be situations where there would be no Federal agency to accept a gift, and whether a Federal agency, in fact, like the park service—they can only accept gifts of land and interest of land that are within the boundaries of their preserves. And, therefore, you might find some situations where there simply wouldn't be a Federal agency authorized to accept a gift that would be in the national interest. But that needs some more research, I think.

Mr. Rod Lucas, of our board, whom you know, and who is a Jackson Hole rancher and an early proponent of these credits has also pointed out that a similar credit for conservation gifts ought to be available against gift taxes, if, for example a landowner gives his children some land during his lifetime and a conservation easement is then given over the property. And finally, the estate tax deduction for unused carryover would be, again, of value in situations of older landowners who would like to make gifts but are not sure they are going to be around to use up anything like the full income tax deduction.

Certainly the clarifications of section 170(h) are also important to us, given the uncertainty of the regulations, although I would like to commend the IRS and the Treasury Department for their great willingness, apparently, recently to listen to the land trust community as they draft their final regulations. The repeal of the restriction on surface mining is one that is of great interest to us. I think it would be of great help as we deal with the problem of third-party mineral ownerships, including those held by the Federal Government. If there can be some assurance that the conservation purposes won't be violated, I think that is the ultimate and the fundamental test and not whether how the minerals will be extracted.

And, finally, I would like to agree very strongly with Kingsbury Browne about the need for an uncoupling of the estate and gift taxes from the income tax deduction. We have a situation right now in Jackson Hole where there are a thousand acres of land which may or may not quite meet the tests of 170(h) because of some mineral rights problems. The landowner would like to give us an easement. He is willing to risk losing the income tax deduction. Very understandably he doesn't want to risk a gift tax on what would be a multimillion dollar gift, I imagine, although it hasn't been appraised. And, therefore, a thousand acres of land very near Grand Teton National Park remain unprotected today because of this gift tax threat, however remote.

These are the highlights of what I think is a very important bill for land conservation.

I want to thank you again and offer our assistance in anyway that we can to see that it gets passed.

Senator WALLOP. Thank you, Jean.

[The prepared statement of Ms. Hocker follows:]

JACKSON HOLE LAND TRUST

UNITED STATES COMMITTEE ON FINANCE

HEARING ON S. 1675

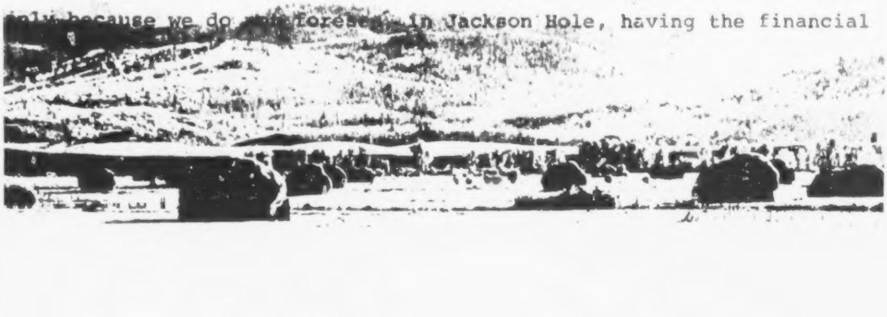
PUBLIC LANDS ACQUISITION ALTERNATIVES ACT OF 1983

6 February 1984

Senator Wallop, members of the Committee, I am pleased to present the comments of the Jackson Hole Land Trust on S. 1675. This is a bill which can have substantial consequences for landowners and organizations like ours throughout the country, and most important, significant benefits for the nation's most outstanding wildlife, scenic and open lands. We thank you for the thought and effort you have directed toward creating incentives and tools for land conservation, including the two summer workshops and a 1981 hearing held in Jackson Hole.

The Jackson Hole Land Trust holds conservation easements on seven properties and over 2,100 acres of land; we have easement projects pending on well over 2,000 additional acres. I can assure you that the proposals included in this bill would almost all assist us greatly. The proposals fall into three categories: those which encourage sales of land and interests in land for conservation purposes; those which encourage gifts of real property for conservation purposes; and those which revise and clarify Section170(h) of the Internal Revenue Code.

I will focus our comments on the proposals relating to gifts and to revisions of Section 170(h). I de-emphasize sales for conservation only because we do [illegible] foresee, in Jackson Hole, having the financial



resources to make many purchases of conservation interests, real estate values being very nigh. Rather, we must depend primarily on conservation easement gifts, either from long-time landowners or from conservation investors, who buy Jackson Hole property not for its development potential but for its wildlife, scenic and open space values.

TOOLS FOR CONSERVATION GIFTS

I preface my comments on proposals for donations by stressing that I know of no landowner who has given a conservation easement just because of the tax benefits involved. In an area like Jackson Hole, where the development demand is high and land values appreciating, no one makes money by giving away development rights. Such gifts are made first because of a desire to protect the land; the tax benefits can decrease the financial loss for those with income to shelter, and are indeed an encouragement, but they are definitely not part of any "get-rich-quick" schemes. The proposals in this bill will not fundamentally change that.

1. Increase in deduction ceiling and unlimited carryover

The increase in the allowable deduction from 30% to 50% of Adjusted Gross Income, and the unlimited carryover would, however, encourage protection of more conservation properties. Even people of substantial means cannot usually deduct the full value of, say, a million dollar gift in six years. Under current tax laws, that would require an AGI of over half a million dollars annually. That certainly eliminates the rancher whose only wealth is his land; and even in Jackson Hole, some of the most significant conservation properties are still owned by descendants of early homesteaders, who are wealthy on paper only. The national interest is best served by protecting critical conservation resources wherever they exist, not just those owned by the very wealthy. We therefore strongly endorse both the increase in deduction ceiling and the unlimited carryover.

2. Estate Tax Credit

Likewise, the credit against estate taxes for qualified conservation gifts would encourage land protection by those of modest incomes, and would make unnecessary the sale of significant conservation property in order to pay estate taxes. However, restricting benefits to gifts made to the United States raises a question. The property may be in an area where the most appropriate federal agency has no aquisition authority. I believe that even in Jackson Hole, with all its federal presence, the National Park Service and National Forest Service can only accept land or interests in land within Park or Forest boundaries. That leaves the Fish and Wildlife Service, which may not want to hold a scenic or open space easement, and the BLM, which may not want to be in the easement business at all. What happens to the landowner's intentions if no federal agency is willing or able to accept and care for the gift? We believe the estate tax credit ought also to be available for gifts to qualified private organizations. Many landowners are, in any event, much more comfortable dealing with a private organization.

Would the existence of an estate tax credit diminish conservation giving during lifetime? Perhaps, in some cases. But I think the net result would be an increase in protected land. As proposed, the credit is a tool for executors and heirs, likely to be used by beneficiaries who would otherwise have to sell or develop to pay estate taxes. This category of people does not now have any opportunity to make conservation contributions. In fact, I doubt there would be widespread use of this tool, but its availablility could nevertheless result in protection of very significant land whose resources would otherwise be destroyed by forced sales.

Mr. Rod Lucas, a Jackson Hole rancher, member of our board, and early proponent of the estate tax credit, also points out that a similar credit for conservation gifts ought also to be available against gift taxes which are due if a landowner gives land to his children during his lifetime. That seems to be a logical extension of the estate tax proposal, and we urge you to consider it.

3. Estate tax deduction for unused carryover

Finally, allowing unused carryover from a qualified conservation contribution to be applied against an estate of the donor would provide considerable encouragement for giving by older landowners. We support this provision as well.

PROPOSALS CLARIFYING SECTION 170(h) OF THE INTERNAL REVENUE CODE

Section 170(h) of the I.R.C. and its draft regulations have produced both opportunities and barriers for potential donors of conservation gifts. We appreciate your efforts, Senator Wallop, first to get the regulations issued and now to deal with some of the potential problems. I also want to give credit to the drafters and reviewers at the IRS and Treasury Department, who are being open and attentive to the concerns of organizations like ours as they draft the final regulations. We eagerly await the results.

1. Repeal of restriction on surface mining

As this repeal suggests, the real test of the public benefit of a conservation contribution ought to be whether or not the conservation purpose will be protected in perpetuity. While it is certainly true that surface mining can be most incompatible with this test, that may not always be the case. Surface mining does not automatically mean an open pit coal mine; it may, for example, mean temporary removal of gravel or ore and subsequent reclamation as a waterfowl pond. Requiring the permanent protection of the conservation purpose ought to suffice and is less arbitrary than singling our all surface mining as incompatible.

The single most serious problem for us, and it relates to minerals, is the matter of third party ownership of minerals, including rights retained by the United States. As you know, the draft regulations virtually disqualify conservation contributions on land where the surface and subsurface rights are in separate ownership, regardless of the conservation values present. After discussions by Land Trust representatives with the Treasury Department and the IRS, we are very hopeful that this problem will be resolved in the final regulations in a manner that upholds the statute and the intent of Congress without stifling easement programs, especially in the West. Again, we commend Treasury and the IRS for their willingness to tackle the problem in an open and thoughtful way.

2. Automatic qualification for gifts to governmental entities

Because terms like "conservation purpose" and "scenic" are somewhat subjective, potential donors of conservation easements need some way to be reasonably sure that a gift will be a qualified conservation contribution under Section 170(h). This provision provides that badly needed "safe harbor". We suggest, however, that not all governmental entities are qualified analysts and recipients of conservation gifts, and even those who are may prefer that a private agency hold the easement. We therefore suggest that this section be modified to include gifts to or approved by a governmental entity, and that "governmental entity" be limited to one with legislated responsibilities for conservation programs.

ADDITIONAL PROPOSAL FOR UNCOUPLING THE GIFT TAX FROM SEC. 170(h)

Finally, I want to discuss a provision which is not now in S. 1675, but which we most strongly urge you to add. Under current tax law, if a taxpayer in good faith donates an irrevocable easement which later is determined not to be a qualified conservation contribution, he stands not only to lose the income tax deduction, but may apparently owe a gift tax on the transfer. This is because the gift tax provisions of the Internal Revenue Code incorporate by reference the income tax exceptions. Thus, the same tests are applied for determining gift tax deductibility as income tax deductibility, specifically, the tests of Section 170(h). Thus a landowner who has the slightest uncertainty about whether an easement will qualify, and who is nevertheless willing to risk losing an income tax deduction, is most unlikely to also risk owing a gift tax on an irrevocable gift. We have a situation like this in Jackson Hole right now, and over 1,000 acres of marvelous land near Grand Teton National Park remain unprotected as a result.

I have not heard of any cases where the gift tax has actually been levied in such cases, and thus the revenue loss should be miniscule, but I assure you that the possibility--however remote--is a real deterrent for a potential donor. We urge you to include in this legislation remedies for this problem.

In closing, I want to thank you again, on behalf of the Jackson Hole Land Trust and landowners who want to protect their land, for introducing S.1675 and for holding this hearing. We know this is a difficult time to propose major tax revisions and that only the most promising of these proposals can be given priority. Yet many of these do not seem to result in significant revenue loss. We hope that a determination of priorities can be made quickly, so that movement toward enactment can begin. We are most willing and eager to help in any way we can.

STATEMENT OF JAN KONIGSBERG, LAND PROJECTS MANAGER, MONTANA LAND RELIANCE, HELENA, MONT.

Senator WALLOP. Jan Konigsberg.

Mr. KONIGSBERG. For the record, my name is Jan Konigsberg. I'm land projects manager with the Montana Land Reliance, which is located in Helena, Mont.

I would like to thank you, Mr. Chairman, for the opportunity to speak on your bill. I suppose as a neighbor of yours our concerns in terms of our land and the citizens of our State, and they are concerned with conserving resources, whether they are public or private, is probably fairly similar.

As you probably know, we are largely a rural State. Our landownership patterns are characterized by very large ranches in the eastern part of the State, several thousands of acres, and smaller ranches as you move toward the major urban areas, although they would just be considered small towns out here.

Basically, we are practitioners—we would like to believe that—of land conservation. We don't consider ourselves experts in tax policy nor necessarily in social policy. And that tends to leave us out of the field of most experts in Washington. However, we are concerned about the fate of the easement. We rely primarily on the conservation easement as a tool for voluntary acquisition of development rights, and we are very concerned with what has been going on with the proposed rulemaking in Treasury. And we wecome every attempt such as yours to insure the viability of that tool.

One thing that you need to realize—and I think everyone in this room must realize—is that the Montana Land Reliance essentially lost 24,000 acres, two ranches, last year because of the uncertainty created by the proposed rules. I agree with Jean Hocker that maybe the most fundamental change that you could bring about—although it's not in this legislation—from a practitioner's standpoint is uncoupling that gift tax. That's the principal reason why people with philanthropic, conservation-minded motives who aren't in this for the financial gain—they had plenty of money in the case of the two ranches and didn't need it—don't donate easements. No one wants to give away something for nothing. So there needs to be some incentive.

The most critical thing would be uncoupling the gift tax. Potential donors would then be willing to give us the easement and take the risk of losing the deduction. But in addition to not wanting to give away something for nothing, no one likes to be punished for good intentions. We were all punished enough as children for that. And we certainly don't want to be as adults.

I think that the uncoupling has got to be looked at seriously. We can support your tax changes. We think that if they were to pass, they would obviously be of significant value to the land conservation movement. We are concerned about anyone interpreting your provision to repeal the mineral rights concerns as being antienvironmental. We don't read it that way. We think that as long as it is clearly understood that the purpose of the provision—that mining would not be inconsistent with the conservation purpose—it should be acceptable. We think State and Federal agencies do that sort of thing all the time, the forest service, State Department natural resources, State lands. There are ways to determine on a case by case basis whether or not there is an inconsistency.

So we think your provision is appropriate. We also agree with your provisions for government acceptance as the basis of qualification. Frankly, I haven't had enough time to study your legislation because I've been working for the last 8 months with the Treasury Department on the proposed rules. And if I have the opportunity at some point here for the record, I would like to describe what has happened.

But, in sum, we met with Treasury last Monday, the Tax Legislative Council. And they were very receptive to our concerns to the point of agreeing entirely. We submitted revised language to Treasury at the beginning of January. They accepted our concerns on three of the major areas, balked at one of them, and have come more than half way on another. Now we think that's very important. We think that Treasury, from everything we have ever heard, has not been as willing as it seems to be in this case to accommodate our interests. Now I should mention that prior to our coming to Treasury, letters were received by Mr. Chapoton, Assistant Secretary for Tax Policy, from virtually every major national conservation group in the country specifically supporting our language revisions. These include the Audubon Society, Ducks Unlimited, the National Wildlife Federation, Friends of the Earth, the Sierra Club, American Rivers Council, the Izaak Walton League, Trout Unlimited, the Wilderness Society and the Environmental Defense Fund. These groups specifically supported our language. I was told that this was the first time that all those groups agreed on anything at once. So we think that this issue is extremely important. We think that the administration needs to realize that the kind of legislation you are proposing and the kind of work we are doing in the field perfectly fits their professed ideology in terms of private sector voluntary activity. And it's private interest working in concert with public goals. And this thing has to be pushed to the limit.

And if you can do it in terms of these tax questions, we support it.

Senator WALLOP. Thank you very much.

STATEMENT OF ROBERT T. DENNIS, EXECUTIVE DIRECTOR, PIEDMONT ENVIRONMENTAL COUNCIL, WARRENTON, VIRGINIA

Senator WALLOP. Mr. Dennis.

Mr. DENNIS. Mr. Chairman, I am Robert T. Dennis, the president and chief executive officer of the Piedmont Environmental Council. We are pleased to be here today to voice strong support for S. 1675.

We are an organization of rural landowners established to conserve the pastoral character and landscape of nine counties in the northern Piedmont region of Virginia.

Today, 13 percent of all private lands in our nine counties have been dedicated by voluntary action to continued rural use, mostly under Virginia's agricultural and forestal district program. The total acreage so protected is 40-percent larger than that encompassed by Shenandoah National Park, which forms the western boundary of much of our service area.

Nearly 25,000 acres in our nine counties have been given protection in perpetuity by landowner donation of open space or conservation easements—usually to State government, in one or two cases to county governments, one to the National Park Service. Indeed, until enactment of the Tax Treatment Extension Act of 1980, the Virginia Outdoors Foundation—a State agency—was receiving easement donations statewide at a rate approaching 10,000 acres per year.

Now the Virginia easement program is dead in the water because of Federal tax policy uncertainties.

By making clear that any open space easement donated to and accepted by a Government entity is a qualified conservation contribution, S. 1675 would remove one of the two major factors in bringing Virginia's easement program to a halt. This provision of the bill, section 2(b), would do away with the current uncertainty of a potential donor as to whether his or her donation will be ruled deductible, with the alternative perhaps being required payment of a gift tax. Section 2(b) would remove such uncertainty in a far more efficient and less costly manner than the private ruling process. And it would recognize the obvious—that a governmental body would neither solicit nor accept an open space easement unless such easement were determined to be in the public interest.

You asked about priorities. In Virginia, State law really says that easements can be taken only by Government agencies (there are some private agencies that have taken them, but I think that they are perhaps on a shakey legal base). In Virginia, I think that our first priority would have to be section 2(b). Now we hope, of course, that the problem will be taken care of in regulations. But I think that it is fair to say that the State agencies involved would much prefer to see a statutory protection.

The Piedmont Environmental Council supports the other features of S. 1675 as well. We make particular note of section 2(a), removing the 5-year carryover limitation, and similarly the provision for an increase in the limitation from 30 to 50 percent. We have heard IRS officials characterize easement programs as tax shelters set up for wealthy landowners. PEC believes, on the other hand, that the Virginia easement program is a sound land management tool, but one that, because of the tax laws, tends to discriminate against low income easement donors. Certainly, section 2(a) will help to remove inequity; some day we hope you might also consider a tax credit option as a way of further reducing inequity.

I would like to mention the second factor that has undercut the Virginia easement program, but it is one that is not addressed by S. 1675. That factor is the problem of setting a value on easement donations.

It appears to us that IRS officials believe not only that open space easements are tax shelters, but that they are "abusive tax shelters." Whatever the reason, in a manner smacking of some governmental system other than democracy, IRS agents late last year went through the donor files of both the Virginia Outdoors Foundation and Virginia Historic Landmarks Commission. So far as I can determine, everyone who donated an open space or historic easement to the Commonwealth of Virginia beginning with 1978 is now being audited by IRS. And one donor after another is being told that his or her easement gift was worth little or nothing with tax deductions being challenged accordingly. That's a quick way to kill a Government easement program relying on voluntary donations.

I might say that I understand that Virginia is not alone in this experience. The Maryland State agency has experienced the same thing. And now one of the large regional private organizations in Pennsylvania has had its donor files pulled.

As an example, in our area the National Park Service is soliciting property gifts including easements to protect Shenandoah National Park. I filed with the staff several copies of a brochure entitled "For Future Generations" put out by Shenandoah National Park and aimed at landowners adjoining Shenandoah National Park. It solicits gifts of their properties, of access across their properties, and of easements. And this brochure makes mention of Federal income tax benefits as well as local real property tax benefits. At least three owners that I know of have donated easements along the park boundaries—one to the National Park Service, two to the Virginia Outdoors Foundation. Now the IRS has essentially told the donors that their gifts had no value. It is not suprising that landowner interest in the protection effort for Shenandoah National Park has diminished markedly.

I might say that the easement evaluation issue may well require attention by this committee. We hear talk about abusive evaluations. I suspect that there are some, and perhaps there are even some intentional abuses. But I must say that the Federal easement acquisition files are full of very thick appraisal documents which, in many cases, give values to easements far above those that are claimed by most of the donors in our area.

And so I guess some questions that I have are these: Are Federal land agencies, which often pay 60 to 80 percent of fair market value for easements they purchase, are those land agencies operating under appraisal standards which waste taxpayer money? Obviously, if the standards are improper, they ought to be corrected.

How can easements given to the National Park Service to protect Shenandoah National Park have a markedly lower value than those purchased by the National Park Service to protect the Appalachian Trail? Or are IRS agents, who often apparently lack the credentials of the appraisers whose work they challenge, simply unfit to pass judgments on values of partial interests in land? I do not believe that S. 1675 can deal meaningfully with the evaluation issue, but I suggest that Congress may have to.

In closing, I would like to note that I serve on the board of directors of the Land Trust Exchange, a national coalition of community landscape protection organizations. Many of those organizations, I believe, share the views I have expressed today.

I thank you for this opportunity to endorse your bill.

Senator WALLOP. Thank you, Mr. Dennis.

[The prepared statement of Mr. Dennis follows:]

STATEMENT OF THE PIEDMONT ENVIRONMENTAL COUNCIL
With Respect to S. 1675
February 6, 1984

The Piedmont Environmental Council (PEC) is pleased to be here today to voice strong support for S. 1675. We are an organization of rural landowners established to conserve the pastoral character and landscape of nine counties in the Northern Piedmont Region of Virginia.

Today, thirteen per cent of all private lands in our nine counties have been dedicated by voluntary action to continued rural use, mostly under Virginia's agricultural and forestal district program. The total acreage so protected is 40% greater than that encompassed by Shenandoah National Park, which forms the western boundary of much of our service area.

Nearly 25,000 acres in our nine counties have been given protection in perpetuity by landowner donation of open space or conservation easements -- usually to state government~~s~~, in one or two cases to county governments, one to the National Park Service. Indeed, until enactment of the Tax Treatment Extension Act of 1980, the Virginia Outdoors Foundation -- a state agency -- was receiving easement donations statewide at a rate approaching 10,000 acres per year.

Now the Virginia easement program is dead in the water because of Federal tax policy uncertainties.

By making clear that any open space easement donated to and accepted by a government entity is a "qualified conservation contribution," S.1675 would remove one of the two major factors in bringing Virginia's easement program to a halt. This provision of the bill -- Section 2(b) -- would do away with the current uncertainty of a potential donor as to whether his or her donation will be ruled deductible -- with the alternative perhaps being required payment of a gift tax. Section 2(b) would remove such uncertainity in a far more efficient and less costly manner than the private ruling process. And it would recognize the obvious -- that a governmental body would neither solicit nor accept an open space easement unless such easement were determined to be in the public interest.

PEC supports the other features of S. 1675 as well. We make particular note of Section 2(a), removing the five-year carryover limitation. We have heard IRS officials characterize easement programs as tax shelters set up for wealthy landowners. PEC believes, on the other hand, that the Virginia easement program is a sound land management tool -- but one that, because of the tax laws, tends to discriminate against low income easement donors. Certainly, Section 2(a) will help to remove inequity; some day we hope you might also consider a tax credit option as a way of further reducing inequity.

I'd like to mention the second factor that has undercut the Virginia easement program -- one not addressed by S. 1675. That factor is the problem of setting a value on easement donations.

It appears to us that IRS officials believe not only that open space easements are tax shelters -- but even that they are "abusive tax shelters." Whatever the reason, in a manner smacking of some governmental system other than democracy, IRS agents late last year went through the donor files of both the Virginia Outdoors Foundation and Virginia Historic Landmarks Commission. So far as I can determine, everyone who donated an open space or historic easement to the Commonwealth of Virginia beginning with 1978 is now being audited by IRS. And one donor after another is being told that his/her easement gift was worth little or nothing, with tax deductions being challenged accordingly. That's a quick way to kill a government easement program relying on voluntary donations.

For example, in our area, the National Park Service is soliciting property gifts -- including easements -- to protect Shenandoah National Park. At least three landowners have donated easements along the Park boundary, one to the National Park Service, two to the Virginia Outdoors Foundation. The IRS has essentially told the donors that their gifts had no value. It is not surprising that landowner interest in the protection effort has diminished markedly.

The easement evaluation issue may well require attention by this committee. Are Federal land agencies -- which often pay 60%-80% of fair market value for easements purchased -- operating under appraisal standards which waste taxpayer money? How can easements given to the National Park Service to protect Shenandoah National Park have a markedly lower value than those purchased by NPS to protect the Appalachian Trail? Or are IRS agents, who often apparently lack the credentials of the appraisers whose work they challenge, simply unfit to pass judgement on values of partial interests in land? I do not believe S. 1675 can deal meaningfully with the evaluation issue. I do suggest that Congress may have to.

In closing, I'd like to note that I serve on the Board of Directors of the Land Trust Exchange -- a national coalition of community landscape protection organizations. Many of those organizations, I believe, share the views I have expressed today.

Thank you for this opportunity to endorse S. 1675.

STATEMENT OF MARK ARTH, ARTH & GREEN, ST. PAUL, MINN.

Senator WALLOP. Mr. Arth.

Mr. ARTH. Thank you, Senator.

For the record, I'm Mark Arth, and our law firm represents Investment Rarities, Inc., which is located in Minneapolis, Minn.

I would like to commend the Senator for the work which he has done and which his subcommittee continues to do on this bill. I would like to say that our interests are somewhat unique from the other parties that testified at this hearing in that we represent a private foundation or a private individual as opposed to publicly supported foundations.

We directed our attention to the corporate area—to the area of the definition of "qualified recipient". Now Mr. Cook and Investment Rarities, Inc., at this time, hold 20 separate pieces of property, located in three States—North Dakota, Minnesota, and South Dakota. And that consists of approximately 10,000 acres of significant wetlands.

Mr. Cook's interest is as an individual. Interests of organizations and the interest of individuals do not necessarily coincide. As way of an illustration, we would point out and I was informed by the previous Commissioner of the Internal Revenue Service that the strongest opposition he had with respect to the increase for the standard deduction on the individual tax returns came from exempt organizations and organized religious groups.

Now with that by way of illustration, Mr. Cook's problems are basically four. First, the acquisition costs of the wetlands are merely the tip of the iceberg. The carrying costs of these properties can be very substantial. By that, I mean the people to operate them.

Second, IRI as a corporation is limited by the percentage limitation which currently applies to corporate taxable income with respect to the amount that it can give to any particular conservation organization.

Third, Mr. Cook does have a 501(c)(3) tax-exempt organization, of which he is president. However, this corporation is not a permissible donee because it does not qualify as a 170(c) organization due to its failure to garner the necessary outside public support as opposed to Mr. Cook's personal support.

Furthermore, he would like to continue to be active in the management and development of these areas. And that presents a problem also. For some reason, the alternative donees (those organizations which would qualify for a section 170 contribution)—for instance, the Sierra Club, the Isaac Walton League, and the other organizations mentioned—sometimes are not really suitable donees for a number of reasons. And they primarily revolve around the fact that they are not equipped to manage these areas. Much of the land that is ultimately contributed is recontributed back to the States, which currently are suffering severe budget deficits.

Now the private sector is also felt to be much more effective and efficient in the management of these areas as opposed to the Government or public organizations. So in summary, IRI's problems and Jim Cook's problems are that we would like to contribute more than the permissible amount qualified for corporate contributions, and contribute it to an exempt organization privately as opposed to publicly supported, and, therefore, not qualified for contributions at this time.

Now I have Mr. Cook with me today, and he's more conversant, through his 20 years of conservation activity, with the problem of why he would be better able to manage it in private organizations and the private sector could be managed in some of the public organizations that currently exist.

We once again commend you for your work on Senate bill S. 1675. Thank you.

[The prepared statements of Mr. Arth and Mr. Cook follow:]

UNITED STATES COMMITTEE ON FINANCE HEARING ON S1675
PUBLIC LANDS ACQUISITION ALTERNATIVES ACT OF 1983
FEBRUARY 6, 1984

STATEMENT OF JAMES R. COOK, PRESIDENT, INVESTMENT RARITIES, INC.
AND MARK ARTH, COUNSEL FOR SAME

For the Record: My name is Mark Arth, and our law firm represents Investment Rarities, Inc. Mr. James Cook, who is here with me today, is the President of Investment Rarities which is headquartered in Minneapolis. Besides being the President of Investment Rarities, Mr. Cook is also a conservationist. His conservation activities spand twenty years and have ever been increasing in scope with a corresponding increase in the amount of money involved. IRI [which is Investment Rarities, Inc.] now owns twenty separate significant wetland areas spread over North Dakota, South Dakota and Minnesota representing approximately ten thousand acres and millions of dollars.

First we would like to apologize for the late submission of our request to speak at this subcommittee hearing.Unfortunately, our request to speak was submitted simultaniously with our receipt of notice of this meeting.

We want to take this opportunity to commend the Senator for the work which he and his subcommittee has done and continues to do on an already expansive and quite complicated bill. We would also like to point out, not as a criticism but as an observation, that Mr. Cook is the only individual here to represent the viewpoints of those parties who are significant benefactors to wetland organizations and have corporate interests. In other words, all the other witnesses scheduled to appear represent tax exempt organizations. Interests of tax exempt organizations and interests of individuals do not necessarily coincide. As a point of illustration, the proposal to increase the standard deduction on individual tax returns met its strongest opposition from 501(3)(C) organizations such as churches and other beneficiaries of individual and corporate contributions.

Our primary concern is to direct some attention to

(i) the corporate area; and
(ii) to the definition of "qualified recipient".

Our problems are many but the most significant ones are as follows:

FIRST: The acquisition costs of these properties are merely the tip of the iceberg. The carrying costs associated with their management and operation are very substantial.

SECOND: IRI is limited in the amount of property which it can donate to any particular conservation organization by the ten percent limitation of taxable income currently in effect for corporations.

THIRD: Though Mr. Cook does have a 501(3)(C) tax exempt organization of which he is President [Wildlife Habitat, Inc.]. This corporation is not a permissible donee because

(i) it has not qualified as a 170 IRC organization due to its failure to garner the necessary outside (public) support as opposed to Mr. Cook's and IRI's support.

(ii) Mr. Cook wants to continue in the active management and control of the organization to which these properties are entrusted. However, he is precluded from doing so by the aforementioned public support requirement for a 501(3)(c) exempt organization.

FOURTH: The alternative donees, those organizations which would provide a section 170 IRC contribution deduction for IRI (i.e. , Issac Walten League, Nature Conservancy, Etc.) are really not suitable donees for a number of reasons which primarily revolve around:

(i) their history of low productivity in the management of these areas; and

(ii) questionable management and stewardship of the properties in the past [i.e. much of the land which is donated to private organizations is ultimately contributed by them back to the states which lack the money to manage them]; and,

(iii) the belief which I feel is shared by all that the private sector is able to accomplish its objtives much more efficiently and effectively than the Government has managed to achieve in the past.

In summary, IRI's problem and Jim Cook's problem is to find a way in which the Government can assist private industry and individuals to accomplish the preservation of America's wetlands and wildlife and avoid the built in penalties previously alluded to with respect to those individuals and corporations who

1. contribute more than the permissible amount qualified for a corporate contribution deduction; and
2. contribute to an exempt organization privately as opposed to publicly supported and therefore not qualified for a contribution deduction.

I feel that some of you must naturally be curious with respect to Mr. Cook's reluctance to donate this property directly and outright to some organization such as those previously mentioned, or for that matter, to the Department of Interior directly. For that reason Mr. Cook has accompanied me here today and would like to address his remarks to that area and would also be anxious to respond to any questions which there may be.

Thank you.

STATEMENT OF JAMES R. COOK:

Thank you, Senator. My name is Jim Cook; I'm the president of Investment Rarities, Inc. in Minneapolis, Minnesota.

I just have a few brief remarks. As Mr. Arth has pointed out, my company owns a number of wetlands and owning this land is just the tip of the iceberg. The management of this land is very expensive, and in order to do the best job for wildlife, it must be managed for maximum wildlife production. My properties are some of the best wildlife producing areas in the country. People who know a lot about his subject believe that my land, which is managed exclusively for wildlife, produces more wildlife than any other equivalent area.

To answer your question, Senator Wallop, as to for whom this wildlife is produced, I would like to say that all my properties are closed wildlife refuges. There is no hunting by anyone, and that includes myself, and there is no agricultural or any other profit-making activities.

My problem is that these lands are all owned by my corporation and I don't have many options as to where this land will go to make sure that these areas are perpetuated after I die or my corporation is gone. Actually my corporation should get rid of this land and my desire is to preserve it as wildlife areas forever.

I appreciate your permission to address this committee and I request the opportunity to work closely with both you and Senator Durenberger in the promotion and protection of this Country's greatest natural resource, its wildlife and wetlands.

Thank you.

STATEMENT OF JAMES COOK, PRESIDENT, INVESTMENT RARITIES, INC., MINNEAPOLIS, MINN.

Senator **Wallop**. Mr. Cook.

Mr. **Cook**. Thank you, Senator. My name is Jim Cook. I'm the president of Investment Rarities in Minneapolis. I only have one brief comment. And that is that ownership of this land is really the tip of the ~~iceberg~~. The management of it, and thereby the increase in the wildlife production on those areas, is a very expensive matter. And it has been our experience that we have increased the wildlife production by a wide margin on these properties. And, of course, that's what we would like to continue doing.

Senator **Wallop**. I guess Treasury's obvious question would be for what purpose is wildlife production increased.

Mr. **Cook**. All my properties are closed wildlife refuges. There is no hunting. There is no agriculture.

Senator **Wallop**. So it's not different from a property in terms of ultimate goal—it would be managed by the Fish and Wildlife Service for the same thing.

Mr. **Cook**. That's correct. I believe the only difference—and as many people will vouch to that effect—the increase in the production of wildlife on our properties is truly significant.

Senator **Wallop**. Are you organized as a foundation or are you just an individual that is—or if you were organized as a foundation, even a private foundation, would that make a difference?

Mr. **Arth**. It's probably a tax problem that I should address. Mr. Cook does have a 501(c)(3) exempt corporation, but being 501(c)(3) means that any money that Mr. Cook gives to the organization itself is not taxable to it. The flip side of that doesn't necessarily mean that Investment Rarities or Mr. Cook would receive a deduction for it on his income tax return.

For Mr. Cook to receive any sort of deduction or for Investment Rarities to receive any sort of benefit from the contribution of that property to wetlands to be used historically and perpetually for conservation purposes, it's now necessary for him to give that property to an organization such as the Wildlife Conservancy, which in turn can—and they are free to reassign the property back to the State of Minnesota, which has been done in the past.

Mr. **Cook**. Senator, to answer your question specifically, if the land is currently owned by my corporation, which creates a tremendous dilemma—I have to get rid of the land is what it amounts to, sooner or later.

Senator **Wallop**. I don't want to go too far into this because I'm not sure where it is taking us. But is one of Treasury's problems or one of our problems in trying to address the complications that it poses to you a question of what happens to that on your death? What happens to your corporation and the holdings that it has? And would they still be for the same purpose?

Mr. **Cook**. Indeed, my goals are to perpetuate those wetlands. And what I need is a vehicle to do that.

Senator **Wallop**. That goes beyond you.

Mr. **Cook**. Indeed. Long after I'm gone, it would be my hope that they would be perpetuated as wild areas.

Senator **Wallop**. Is it a private organization?

Mr. Cook. It's privately held by myself and three or four other stockholders.

Senator Wallop. Well, that's as far as my tax brain will go.

The difficulty that we have is the part expressed by you, Jean, and partly expressed by Mr. Dennis. And it relates both to evaluations and to the ability to continue to manage and to be competent to manage. And I guess the first question I have is with regards to this setting of value. How do we do that? I mean how do we put language in here that satisfies a public interest in this which won't go away no matter how much we would like it in terms of the value and everything else because you know what 20-20 or 60 Minutes or Jack Anderson or somebody might do to all of us if there was an abuse? How do we go about setting those values?

Mr. Dennis. Mr. Chairman, I'm not suggesting that this bill ought to try to do that. I think that that is an issue beyond this bill. It might be helpful for the subcommittee, however, to look at the question and try to get some ideas on the table as to why there is such a range in these perceptions of value. There is an effort going of now, as I think Mr. Konigsberg alluded to, to try to come up with some evaluation guidelines that would be acceptable by our part of the community as well as by IRS. That's a step in the right direction. I hope it works out. It's a positive effort that the land preservation community has launched. I guess I am—I think there are going to be some loose ends left. And I think it may help to try to understand why the perceptions of values range as widely as they do. I have some ideas on that which I submitted earlier in your workshop days. And I'm concerned that until we have an awful lot more property under easement, and it has begun to trade hands, and we see what happens over time to some of these areas where there are clusters of easement protected property, we may not be able to come to any generally accepted——

Senator Wallop. And what happens in 15 years. That would be a nice problem to have to solve. To have a whole lot of land that had a high value because of its easements. At least we would have succeeded in the one thing that we set out to do which was to protect something and visualize its value.

Mr. Dennis. I guess the point I'm trying to make is that one of the appraisers that I deal with sounds to me very pessimistic about this evaluation problem right now because of the short history of easement programs and the very, very few properties that are covered by easements that have turned over. And, in fact, that the evidence is so scattered.

Senator Wallop. Jean, in your remarks you were mentioning a fairly sizable easement which is troubled by these various things. Could you tell us with respect to both the pending regulations and this legislation what changes in the law, in my proposal, that are suggested here or have not been suggested here, would have allowed you to receive more in that package than you actually received?

Ms. Hocker. Yes, Senator, thank you. This is a gift that a landowner would like to make to us. He, at the monent, does not own the mineral rights under the property. He has given us an easement over the portion of the property on which he does own the mineral rights. And that has been a wonderful gift. On the remainder of his property, he does not own the mineral rights. They are reserved to the Federal Government.

And, therefore, under the current regulations, currently proposed regulations, it's very difficult, if not virtually impossible, for him to meet the criteria of section 170(h) unless those regulations are changed to make allowances for third party mineral ownerships.

That's part of the problem. He would, as I understand it, nevertheless donate the easement because his primary motive is to protect the land. And he would forego the income tax deductions, but he doesn't want to incur the gift tax, obviously. Therefore, there are two things. One would be the clarification of the regulations on 170(h) that would make allowances for the third party ownership. I would like to see for starters third party ownerships that are in the hands of the U.S. Government, and always were, be excluded from this consideration because I think that's not the fault of the landowner. And if the United States on the one hand decides that the property is so valuable for conservation purposes that it deserves a tax deduction, and on the other hands the U.S. owns the mineral rights under that property, and has control over how they are used, I think that's the two hands of the one entity that has control over what happens to that.

And, secondly, the things that Jan Konigsberg was discussing, would help, that is, when you don't own the mineral rights, you nevertheless can submit tests that would show that the extraction either is so remote as to be negligible or the method of extraction is not likely to conflict with the conservation purposes. And, of course, the elimination of the surface mining prohibition in your bill would clarify the intent of Congress in that regard.

All these things would be helpful. And, secondly, of course, the uncoupling of the gift tax would get at the other side of the problem.

Senator WALLOP. Is that a similar experience with you?

Mr. KONIGSBERG. Yes, sir. On the two most recent ranches, the principal concerns were the third party ownership on the mineral rights. And in one case, a problem with the notion of prior transfer with oil and gas leases, whether or not they actually constitute prior transfer.

We have an advance ruling from an earlier situation. But advance rulings are not necessarily precedents. So in both cases attorneys advise them to wait.

Senator WALLOP. It's interesting. Again, going back on this question of evaluation, to your knowledge has the IRS pulled the files on any of your members? Yours are probably much more recent than those in Virginia. Are your people being audited?

Ms. HOCKER. Not to my knowledge. There was one gift that was given to the county a few years ago that I understand was questioned. There were some questions, and I don't know how it was resolved because it wasn't our gift. But, no, there has not been the kind of wholesale examinations up to this time that Bob has experienced.

Senator WALLOP. Have you?

Mr. KONIGSBERG. No, we haven't had the kind of investigation that Mr. Dennis referred to. However, there have been, I believe, three properties in Montana that have been audited, and the problem in most of the cases had been valuation—we are holding an easement on one and I believe the Conservancy is holding it on another—but in our case the one with which we are familiar, with the initial IRS agent said we don't think this is going to qualify as meeting the criteria of the Tax Treatment Extension Act, and I also think your valuation is at least 50 percent off. Well, you know, the taxpayer is able to go to IRS engineers, which are in house consultant groups to the IRS, so when the IRS engineer visited, no problem with the qualification, no problem with the valuation. So I would submit that probably much like other departments of the Federal Government, depending on what region of the country you are in, and the individuals involved, there are disparate notions of what that law means and what their duties under it are.

And what is happening on the east coast may or may not reflect what may happen in the West, depending on what agents do what. I have heard that if an agent picks up on an abuse it can become a fad with the agency for a period of time, and it can be dropped.

But there is absolutely no way of knowing what is going to happen.

Senator WALLOP. From your testimony, it's virtually everyone, every gift that you have received.

Mr. DENNIS. Yes. I really can't testify about what has happened outside of Virginia except that I hear that other people have had the same thing. But in Virginia the IRS did get the name and address of everybody who donated to either an open space easement or a historic easement, starting with 1978 and coming to the present day. And those donors—I know many of those people. In fact, I was the one that encouraged some of them to make easement gifts. So I feel a party to this action. And the donors have told me that they have been notified that their returns will be audited for those years. And I believe that they picked 1978 because 1983 was the last year of carryover for 1978.

And also, besides the audit itself, each of the donors is being given a lengthy list of questions which they are being asked to answer—which several of them say that they are personally unable to provide the answers and may have to go back and hire somebody to redo the original appraisal effort. And they just see this as a terrible expense.

I'm not sure why this is happening. I do know that we have a lot of donors who are quite upset and who feel that they are being asked to expend a great deal of money these days to justify what was done in 1978. And it has just created a terrible problem for the whole program.

Senator WALLOP. Lindsey Hooper of my staff just informs me that this may be—not the mention of it, but the fact of it—as a result of what we did in the Tax Treatment Extension Act by asking Treasury to find out what had been going on and where we were in it.

Mr. DENNIS. That thought has occurred to me. And I think there probably is a connection. There was a requirement in the 1980 act for a report to the Congress about these easements. It just seems to me, however, that the agency, the IRS, could have gone to Richmond and could have found out who gave easements, could have examined the records that it had on file, and maybe made some professional appraisal of how good or bad the returns were. And IRS could have worked directly with the State agencies involved to try to develop some of the other information without directly involving the individual donors who at the time of their gift apparently did nothing that triggered an audit because of their tax returns.

I believe that, in fact, the Virginia Outdoors Foundation, at least, is going to suggest to the IRS that, instead of sending these lengthy questionnaires and asking each donor to sort of recreate the past history of their general area, maybe there could be a way to get this information between the State and the IRS without involving the donors—information on market histories and so forth. It's going to be the same for an awful lot of those donors. So the State is going to try to follow up in that way.

I don't know if this was part of a survey. I guess I do not understand why each donor has to be involved in the way they apparently are.

Senator **Wallop**. Well, it's not always easy to turn that elephant loose and then have it walk slowly. [Laughter.]

That's sort of nature of the Government. If that's the case, we apologize for the specific problems that taxpayers have, but still we hope that the information justifies what we are doing here and trying to proceed with.

Well, I appreciate the distance that you have traveled—you, especially, Jean—to come here, and others, and the help that you are giving us on this.

Let me just ask one general question. And that is those of you that have been working with the IRS recently on these regulations, is it your feeling that they have been trying to make something go out of it?

Mr. **Konigsberg**. I can answer that. We had a September hearing, which we understand was the second largest hearing in IRS history. The IRS and Treasury asked for some suggested language to basically frame our concerns in rulemaking language. As a result of that request, a number of the major land trusts met in Montana in November and arrived at a concensus regarding five major issues and the language. Attorneys Kingsbury Browne and Bill Hutton then went back and drafted and submitted that language to Treasury at the beginning of January.

Kingsbury Browne, Bill Hutton, and myself met with Treasury on Monday. And it was clear that not only had they studied the language—and it was a fairly substantial piece of language, over 30 pages—as I indicated they agree basically on three and a half of the major five issues. They basically agree on minerals, they agree on the prior transfer, on the inconsistent use problem. They agree that farmland should qualify not only if it's pursuant to a Government program for flood control and prevention, but for food and fiber production so long as it's a clearly delineated Government policy.

They didn't agree on the identification of lands by the Secretary of the Agriculture under the Farmland Policy Protection Act, which is something we would be more comfortable with if they would say that was pursuant to a Government policy, and has significant public benefit.

They stopped at that point. And they balked entirely at the provision that we call procedural safe harbor among the land trust community. It is basically a presumption that given certain procedures that easement will qualify. It's up to the Internal Revenue Service to show that the presumption is incorrect. It's not an absolute safe harbor. It would merely give the landowners' attorneys a basis on which to issue an opinion on whether or not an easement will qualify. That is currently lacking.

And we felt—in answer to you question—that Treasury has been very receptive. The Tax Legislative Counsel, particularly. They have been very receptive to our suggestions, and we have every hope that those major problems will be solved by rulemaking.

Initially, a number of us thought that we would have to go for legislation to address those questions. But we would be most comfortable, Senator, if it is handled within the rulemaking because it would allow us to get on with our work.

Senator WALLOP. Yes.

Mr. KONIGSBERG. One other thing I would like to mention is that there was concern about the public access question, as you may know, in the proposed rules. We had heard that they were going to bring that up again. That is, requiring public access.

Now in the West, as you know, and in most farmland around, ranchland, no one would donate an easement if it required public access. The Tax Legislative Counsel has assured us that that is not going to be in the final rule.

And, lastly, we asked for a time to expect the final rule, because our concern is how long before the final rules are out. And at that point IRS said that if you want a date, we will give you one, but don't hold us to it. And that was 6 months. From our perspective that's too long. They have the information they need, they have the language they need to make a decision, and the chief counsel on this is going to have a baby within the next few weeks and disappearing from the scene, which leaves no continuity at Treasury. So our major concern is that these things be handled more expeditiously than they seem to indicate, even now than they will be.

Senator WALLOP. Are you talking about the rules or the babies? [Laughter.]

Mr. KONIGSBERG. We hope that both will occur for the sake of the counsel.

Senator WALLOP. You can't do much about the natural process.

Well, in many respects these are new concepts. But clearly it is time we had some new ones. We have bumped up against a problem that is both unfair to the people that hold lands that have been designated as in the national interest, and unfair to the public who has a national interest in lands that it could have and we can't find a way to get them there.

And there simply isn't enough money hanging around in State governments and Federal Government and foundations and other things in which to get all of these interests without something more creative than what we have been doing. We have got a little start on it. And I think it's really important to get as much interest as you can, legislative interest, expressed through your Members of Congress, Senators and other of these land trust groups that exist throughout the country so that we have a broad basis of support.

I don't have a hard time seeing why Treasury is a little upset because it's very difficult to say how much revenue might be affected by this. But it's not very difficult to say how much revenue it would cost to buy it all that there that is in the national interest. And it's even less difficult still to identify what would happen if we lost.

It really is important. It's now a political problem, frankly, more than a revenue problem. It's a problem of getting enough people in the country to suggest that that is in their interest, in the national interest.

And so if you all can do that on your own and suggest to me how we can go even farther, I'm most open to it. At least in part it will go along now. And in the future we really need the expertise that you have developed from trying to deliver the goods as it were to the country from the standpoint of you who are foundations, and those of you who are tax experts or legal experts and the problems that you have had in trying to secure for willing donors the security that they need before they are really willing, or would be willing donors. The security that they really need in order to become willing.

So anything that we can do to tailor this to those events and support that we can get from those of you with experience with the Treasury will be most welcome. We will push it and see how far we can go.

Thank you very much. We appreciate everybody being here this morning.

[Whereupon, at 11:41 a.m., the hearing was concluded.]

[By direction of the chairman the following communication was made a part of the hearing record:]

802/457-2369

Ottauquechee Land Trust, Inc.

39 Central Street • WOODSTOCK, VERMONT 05091

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/ Executive Director

Richard W. Carbin
Woodstock Office
(802) 457-2369

Counsel

Darby Bradley
7 Main Street
Montpelier, Vermont 05602
(802) 223-2328

Southern Vermont

William H. Schmidt
RD 1, Box 200
Brattleboro, Vermont 05301
(802) 257-0233

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Charlotte, Vermont 05445
(802) 425-3548

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(802) 457-3731

Forester

Mollie Beattie
Box 125
Grafton, Vermont 05146
(802) 843-2211

February 16, 1984

Mr. Roderick DeArment, Chief Counsel
Senate Finance Committee, Room 208
Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. DeArment:

The Ottauquechee Land Trust would like to take this opportunity to comment on some of the provisions contained within the Public Lands Acquisition Alternatives Act (S.1675) introduced by Senator Malcolm Wallop. The Trust is a 501(c)(3) organization which works throughout the state of Vermont to protect farmland, productive forestland, and other natural resource lands. Although we are a relatively new organization (founded in 1977), our approach to land acquisition and protection has generated a good deal of support among landowners and local and state governments in Vermont. There a number of provisions in S.1675 which would be highly beneficial to our program, and which we would therefore like to support.

Safe Harbor for Conservation Easement. Since the passage of the 1981 Tax Treatment Extension Act and the issuance of draft IRS regulations last year, there has been a good deal of uncertainty about when donations of conservation restrictions (easements) on farm and forest land will be considered tax-deductible. Vermont happens to have passed a myriad of regulatory, incentive, and other types of laws which are intended to encourage the conservation of these lands, so that the Trust feels it can meet the "significant public benefit" and "pursuant to a clearly delineated...policy" tests in most of its projects. However, landowners who are contemplating giving up a significant portion of the value in their land by gifts of conservation restrictions may feel somewhat less confident, since neither the statutes, the congressional reports, nor the draft regulations provide much guidance except in exceptional cases.

Seeking governmental approval at the state or local level in order to achieve the "safe harbor" would not be a burden on the Trust or the landowners it works with. Indeed, a number of towns in Vermont have hired the Trust to help them develop and implement local agricultural land or open space protection programs. In several of the 42 conservation agreements which the Trust has completed in the past 3-1/2 years, the conservation restrictions are held jointly by the Trust and the town or state government. Senator Wallop's proposal would go a long way in clearing up the uncertainty presently surrounding gifts of conservation restrictions.

Increase Deduction Ceiling from 30 to 50 Percent. This change would be more beneficial to the promotion of private land conservation activities than even increasing the lifting of the 5-year charitable deduction carryover. The Trust works with many landowners who are of modest means and whose principal objective is to insure that their land is protected for the benefit of future generations. However, the value of their land may be very high in comparison with their annual income, and in placing restrictions on their property, they are giving up the possibility for greater financial giving in the future. It would be helpful if the Trust could offer thse people greater financial benefit in entering into a conservation transaction by allowing a charitable deduction up to 50% of adjusted gross income instead of only 30%. In the long term, private conservation efforts will protect more land for the future and at a lower public cost than if government tried to purchase the land or conservation restrictions outright.

Estate Tax Deduction. The estate tax credit provision in S.1675 is intriguing, but the Trust would like to offer a slightly different proposal for the Committee's consideration. On several occasions, we have run into a situation where a landowner has died leaving a farm or other land as the estate's major effects, where there is a sizable estate tax due because of the value of the land, where the heirs have low or relatively modest taxable incomes, and where the heirs would like to see the land placed under conservation restrictions. If the decedent has left a will giving a charitable organization a remainder interest in the property, the heirs may disclaim all or a portion of their interest in the property. The property then passes to the charity and is treated, for estate tax purposes, as if the gift were made directly by the decedent. In other words, the value of the heirs' disclaimed interest is treated as a charitable contribution for estate tax purposes.

If, on the other hand, the will is silent, any attempt by the heirs to disclaim or transfer an interest to a charitable organization may create a deduction for income tax purposes, but not for estate taxes. In other words, the estate tax is still due on the full value of the property. The transfer of conservation interests to the charitable organization is deductible only from the estate's or the heir's income taxes. Under the facts which I have described, the property may have to be sold in order to pay the estate tax. The charitable deduction for income taxes comes too late and produces too little.

If the heirs had been able to waive or disclaim all or part of their interest in a farm or other conservation land to the charitable organization, and have that donation recognized for purposes of estate taxation rather than income taxation, a number of transactions could have been completed, but instead collapsed because of the estate tax burden faced by the heirs. There should be some time limit in which the heirs must make a decision, but the rules governing disclaimers could provide guidance here. The Trust feels that such a provision in S.1765 would have a positive impact for conserving important natural resource lands, even where the decedent, through inadvertance or otherwise, failed to make adequate plans for the conservation of his estate.

There are provisions in S.1765 which would have a positive influence on land conservation programs generally. However, the Trust either has not come across situations in which these provisions would be crucial, or other persons in the field have already commented on them more expertly than we could.

We appreciate this opportunity to offer the Senate Finance Committee our views.

Sincerely,

Darby Bradley

Darby Bradley
Counsel

DB/CL

Report No. 84-48 ENR

Congressional Research Service
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AN OVERVIEW OF FEDERAL TAX POLICIES ENCOURAGING DONATIONS OF CONSERVATION EASEMENTS TO PRESERVE NATURAL AREAS

Richard W. Dunford
Consultant
Environment and Natural Resources Policy Division
February 29, 1984

ABSTRACT

In broad terms, conservation easements are legally-binding restrictions on the development of natural areas (such as wetlands, scenic lands, and prime farmland). Federal tax policies encouraging the preservation of natural areas via donations of conservation easements to qualified organizations are examined in this report. Specific topics addressed include the antecedents of the current law, the provisions and intent of the current law, proposed IRS regulations, concerns about proposed IRS regulations, and bills introduced in the 98th Congress that would modify Federal tax policies concerning conservation easement donations.

NOTE

Richard W. Dunford is an Associate Professor in the Department of Agricultural Economics at Washington State University (Pullman). He has written extensively on rural land use problems, conflicts, and policies. This report was prepared for the Environment and Natural Resources Policy Division of the Congressional Research Service in the Library of Congress (Washington, D.C.) in partial fulfillment of contract 83-30.

AN OVERVIEW OF FEDERAL TAX POLICIES ENCOURAGING DONATIONS OF CONSERVATION EASEMENTS TO PRESERVE NATURAL AREAS*

BACKGROUND

Preserving Natural Areas

The United States contains a large quantity of natural areas deemed to be socially significant. In the broadest terms these areas include (but are not limited to): land providing critical wildlife habitat (e.g., wetlands in the Prairie Potholes region in the Dakotas and Minnesota); outstanding scenic areas (such as the Columbia River Gorge in the Pacific Northwest); coastal barrier islands; unique geologic resources (e.g., the Grand Canyon); and prime or unique farmland. For various reasons, many governmental policies have been enacted to preserve some of these natural areas. 1/

The approach most commonly used by the Federal and State governments to preserve natural areas involves the purchase of the pertinent property. 2/

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* Source material is cited by author and date; a full bibliographic citation for each document is provided on page 43 or 44.

1/ An analysis of the rationale for governmental intervention to preserve natural areas is beyond the scope of this report.

2/ Most of the present Federally-owned land in the United States was purchased from other countries and then "reserved," i.e., not sold to individuals or corporations. However, the Federal Government has also purchased a significant amount of land in recent decades from the private sector to create new parks, wildlife refuges, etc. For more information on the acquisition of Federal lands, see Clawson (1983).

In addition to the purchase price, which can be large, additional governmental expenditures are required for the management of acquired natural areas. Since public ownership removes the land from local property tax rolls, payments in lieu of taxes are generally made to local governments. Thus, Federal purchase of natural areas can be quite expensive.

In contrast, local (and some State) governments generally attempt to protect natural areas using a regulatory approach. For example, a county government may try to limit development on high-quality farmland through exclusive agricultural zoning. Although zoning restrictions necessitate relatively low governmental expenditures, they may significantly lower the value of restricted property. Consequently, zoning restrictions may impose an "unfair" burden on landowners. 3/ Furthermore, zoning and other regulatory land use controls are often ineffective in the face of economic pressures for development.

In summary, the purchase approach is an effective way to preserve natural areas, but it requires significant governmental expenditures. Although the regulatory approach requires very little government money, it is often ineffective, and it may impose an "unfair" burden on some landowners. The acquisition of conservation easements is an intermediate alternative to the purchase and regulatory approaches to preserving natural areas.

Conservation Easements

Full ownership of real property involves acquiring the estate in fee simple.

3/ If zoning lowers property values enough to be considered a "taking," then landowners must be compensated. The point at which this occurs is a matter of considerable controversy (Costonis, Berger, and Scott 1977).

> This estate denotes the maximum amount of legal ownership and the greatest possible aggregate of rights, powers, privileges and immunities which a person may have in land. (Madden 1983, p. 109)

In effect, full ownership of property consists of a "bundle" of individual rights, such as the right to exclude others from trespassing, the right to sell or bequeath the property, and the right to farm the property. These rights are only limited by any previous legal restrictions or governmental regulations applicable to the property.

Under Anglo-American law, some rights in the "bundle" can be transferred to others while retaining the remaining rights of ownership. In other words, a less-than-fee (or partial) interest can be donated, leased, sold, or bequeathed from one person or corporation to another. An easement is one such partial interest. 4/ An easement is simply a right that one person or corporation has in the use of another's property. 5/

Easements have been used in the United States for over one hundred years to acquire rights-of-ways in cities for sidewalks, utility lines, and the like. In recent years easements have also been used to preserve natural areas such as wetlands, prime farmland, scenic lands along "wild and scenic" rivers, and nature trails. 6/ In these cases alterations of the property (e.g., draining and filling wetlands) that would adversely affect the natural attributes of

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4/ Restrictive covenants and equitable servitudes are other types of less-than-fee interests. These types of partial interests are contrasted with easements by Madden, who has concluded that easements have "the greatest potential as an effective conservation tool" (1983, p. 113).

5/ For thorough discussions of various legal aspects of easements (e.g., assignability, enforceability, and recordation requirements), see Netherton (1979) and Madden (1983).

6/ Public programs using easements to preserve natural areas actually date back to the 1930s. However, most of these programs were initiated in the last twenty years (Coughlin and Plaut, 1978).

the site are generally restricted. Hence, these land use restrictions are variously known as conservation easements, development rights, conservation restrictions, open space easements, development easements, scenic easements, and wetlands easements. The term "conservation easement" is used generically in this report to refer to this type of land use restriction. 7/

In situations where it is only necessary to control the use of land (rather than own it) in order to achieve certain preservation objectives, conservation easements may be preferable to both fee simple purchase and regulatory measures. Unlike zoning and other regulatory land use controls, conservation easements are not readily subject to legislative changes. Consequently, conservation easements may more effectively restrict land uses. Landowners are compensated for these restrictions, but acquiring conservation easements is less (possibly much less) costly than fee simple acquisition. Furthermore, the land burdened by a conservation easement remains in private ownership; the owner continues to pay some State and local property taxes on the land. The grantee must periodically monitor compliance with the terms of the easement, but no explicit management is required. So the management costs of conservation easements are generally less than those of governmental ownership.

7/ Most conservation easements are technically "negative easements in gross." A negative easement restricts the use of the grantor's land (the servient tenement) in specific ways. An easement in gross is an easement where the grantee does not own any land adjacent to or nearby the grantor's property. Thus, a negative easement in gross involves restrictions on the use of property that do not benefit nearby property of the holder of the easement. An easement prohibiting the construction of buildings on prime farmland that is donated to a nonprofit, charitable organization that owns no land in the area is an example of a negative easement in gross.

Focus of this Report

Although conservation easements can be purchased, donations of these partial interests are the focus of this report. 8/ Specifically, Federal tax policies that encourage donations of conservation easements for the preservation of natural areas are examined. As discussed below, landowners who donate conservation easements to certain kinds of organizations may receive Federal tax benefits through deductions allowed for charitable contributions. This has resulted in essentially a public-private partnership for the preservation of natural areas; the Federal Government partially compensates individuals via tax breaks for their conservation easement donations to private, charitable organizations that specialize in land conservation. Although donations cost the Federal Government less than the purchase of conservation easements, the Federal Government has less control over what natural areas are preserved through donations. As might be expected, the amount of Federal tax benefits and eligibility requirements for these benefits have been the focus of recent debate.

This report is divided into five major sections. In the first section, the antecedents to the current Federal statutes concerning donations of conservation easements are briefly reviewed. The current Federal statutes on conservation easement donations are discussed in the second section. Proposed Internal Revenue Service regulations pursuant to these statutes and some concerns expressed about these proposed regulations are then summarized in sections three and four. The final major section is devoted to an examination of bills introduced in the 98th Congress that would modify Federal tax policies concerning conservation easement donations. A short conclusion follows that section.

8/ Conservation easements can also be acquired through "bargain sales," where a landowner sells a conservation easement at less than its full value. This approach is simply a combination of the purchase and donation approaches.

ANTECEDENTS OF THE CURRENT LAW

Pre-1969 Policy

Income, gift, and estate tax deductions have been allowed for charitable contributions since virtually the inception of these taxes (Liles and Blum 1975). Contributions of cash, stocks and bonds, other personal property, and fee simple interests in real property qualify for these deductions. So a taxpayer can get income, gift, and estate tax deductions for donating his or her entire (fee simple) interest in a parcel of land to qualifying, charitable organizations. 9/

The Internal Revenue Service (IRS) first allowed an income tax deduction for a conservation easement gift in 1964 (Revenue Ruling 64-205). The taxpayer had donated a scenic easement to the United States. The easement restricted development in perpetuity on the taxpayer's wooded property, which abutted a Federal highway. Since the easement was considered a valuable, enforceable property right in the State where the land was located, the IRS allowed the deduction despite no specific provisions in the Internal Revenue Code (IRC) regarding gifts of partial interests in real property (Kinnamon 1980, p. 4 and Hambrick 1981, p. 347).

9/ Over the years many changes have been made with respect to what types of organizations qualify as being charitable. For more information, see Liles and Blum (1975, pp. 24-41).

In 1965 the IRS advertised the availability of income tax deductions for gifts of scenic easements to qualified recipients (governmental agencies and charitable organizations) in an informational news release (Small 1979, p. 306). This news release was followed by other revenue rulings that expanded and clarified tax policy with respect to conservation easement donations. Gifts of other types of partial interests in real property (such as fractional undivided interests 10/ and remainder interests 11/) were also recognized as tax deductible by the IRS (Browne and Van Dorn 1975).

Tax Reform Act of 1969

In response to perceived abuses, Congress restricted charitable deductions of partial interests in real property in the Tax Reform Act of 1969 (P.L. 91-172). This act added sec. 170(f)(3) to the IRC, denying income tax deductions for donations of partial interests not in trust. 12/ Only three exceptions were allowed--permitting deductions for donations of (1) a remainder interest in a personal residence or farm, (2) a partial interest if it was the taxpayer's entire interest in the property, and (3) an undivided portion of the taxpayer's interest in the property. Since an easement does not legally meet

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10/ A fractional undivided interest is a portion of each and every interest of a landowner, extending over the entire term of his or her ownership, e.g., 15% of full ownership of a parcel. A conservation easement is considered a divided interest.

11/ A remainder interest is a future interest in property that takes effect after a specific period of time or upon the death of the grantor. For example, an individual may donate property to an organization, but retain the use of the property for the remainder of his or her lifetime. The organization has received a remainder interest.

12/ In general, contributions to or for the use of a trust are not tax deductible (IRC sec. 170(f)(1)).

any of these three exceptions, the Tax Reform Act of 1969 technically eliminated deductions for conservation easement donations.

The conference report on the Tax Reform Act of 1969 indicated that the conferees intended that an open space easement be considered an undivided interest if the easement was granted in perpetuity (Browne and Van Dorn 1975, p. 73). On the basis of this intent, IRS promulgated regulations that continued to allow income tax deductions for gifts of conservation easements. Furthermore, the IRS also allowed estate and gift tax deductions for donations of open space easements because the Tax Reform Act of 1969 also exempted contributions of an undivided interest in property from these taxes.

Subsequent IRS rulings and court decisions supported these IRS regulations and led to a broad interpretation of open space easements. 13/ Nevertheless, the lack of explicit IRC authority for deductions resulting from conservation easement gifts contributed to great uncertainty.

Tax Reform Act of 1976

Explicit statutory authority for income, gift, and estate tax deductions involving conservation easement donations was first contained in the Tax Reform Act of 1976 (P.L. 94-455). This act amended IRC sec. 170(f)(3) to allow deductions for (among other things) conservation easements having a term of at least 30 years and remainder interests, given to a governmental agency or appropriate nonprofit organization exclusively for "conservation purposes." These purposes were defined as:

13/ For a discussion of some of the IRS rulings, see Kinnamon (1980, p. 6).

(i) the preservation of land areas for public outdoor recreation or education, or scenic enjoyment;
(ii) the preservation of historically important land areas or structures; or
(iii) the protection of natural environmental systems. (P.L. 94-455, sec. 2124(e)(1))

Furthermore, the Tax Reform Act of 1976 formally extended estate tax and gift tax deductions to donations allowed under sec. 170(f)(3), namely, donations of a remainder interest in a personal residence or farm, an undivided portion of the taxpayer's entire interest in property, term easements granted to qualified organizations for conservation purposes, and remainder interests given to qualified organizations for conservation purposes.

Reportedly due to a drafting error (Small 1979, p. 315), the authority for deductions for qualifying term easements and remainder interests was to expire on June 14, 1977, less than a year after the Tax Reform Act of 1976 became law. It was generally accepted that the 1969 "undivided" interest exception still applied to donations of perpetual easements (Kliman 1981, p. 523). Thus, the "conservation purposes" test was only applicable to term easements and remainder interests.

1977 Amendments

Legislation was introduced in 1977 to extend the expiration date of the pertinent provisions of the 1976 act by four years to June 14, 1981. This change was eventually accepted as part of the Tax Reduction and Simplification Act of 1977 (P.L. 95-30). However, at the insistence of the U.S. Department of the Treasury, deductions for term easements were eliminated by this act (Small 1979, p. 317). Thus, all perpetual easements apparently had to meet the "conservation purposes" test in order to be deductible after June 14, 1977. 14/

Subjecting perpetual easement donations to the "conservation purposes" test represented a potentially significant curtailment in the deductibility of these donations relative to the fairly liberal IRS interpretation of the Tax Reform Act of 1969. However, the IRS never promulgated regulations to implement the 1976 and 1977 acts. Furthermore, subsequent Treasury rulings continued to uphold deductions of conservation easement donations based on the 1969 "undivided interest" exception (Kliman 1981, p. 523).

TAX TREATMENT EXTENSION ACT OF 1980

Provisions

Significant new restrictions pertaining to the deductibility of conservation easement donations were enacted in section 6 of P.L. 96-541, which was signed into law on December 17, 1980. These restrictions were based upon concerns "with 'aggressive valuations' and suspected abuse of easements by landowners more interested in private protection than public benefit" (Browne 1983, p. 70). P.L. 96-541, known as the Tax Treatment Extension Act of 1980 15/, revised the list of deductible partial interest contributions to include:

(i) a contribution of a remainder interest in a personal residence or farm;
(ii) a contribution of an undivided portion of the taxpayer's entire interest in property; and
(iii) a qualified conservation contribution. (IRC sec. 170(f)(3)(B))

Deductions allowed for contributions of a taxpayer's entire interest (even if only a partial interest) in real property were not affected by P.L. 96-541.

"Qualified conservation contribution" is defined in a new section 170(h) of the IRC created by P.L. 96-541. 16/ According to IRC sec. 170(h)(1) a

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14/ There is some confusion on this point since Congress did not explicitly indicate that the provisions adopted in the 1976 and 1977 acts supplanted the "undivided interest" exception to the Tax Reform Act of 1969 (Kliman 1981, p. 523).

15/ P.L. 96-541 is formally titled "Temporary Tax Provisions--Extensions." The section on conservation easements was previously a separate bill titled "Tax Treatment Extension Act." The latter title has been commonly used to refer to the entire public law. See Kliman (1981, p. 524) for a brief legislative history of P.L. 96-541.

"qualified conservation contribution" must be a "qualified real property interest," made to a "qualified organization," "exclusively for conservation purposes." A "qualified real property interest" includes:

(A) the entire interest of the donor other than a qualified mineral interest;
(B) a remainder interest; and
(C) a restriction (granted in perpetuity) on the use which may be made of the real property. (IRC sec. 170(h)(2))

Conservation easements would be a "qualified real property interest" under the last category, i.e., IRC sec. 170(h)(2)(C).

"Qualified real property interests" must be donated to "qualified organizations," according to IRC sec. 170(h)(3). These organizations include governmental units, publicly-supported charities, and other organizations that qualify under IRC sec. 509(a)(3). Most nonprofit conservation organizations (including so-called land trusts 17/) meet the criteria for a publicly-supported charity. Although a broad array of organizations are qualified to accept donations of partial interest in real property according to Federal law, some States are more restrictive (Kliman 1981, p. 527). Since a conservation easement must be valid and enforceable under State law as a prerequisite to Federal tax benefits, qualified donees may actually be more limited in some States.

Perhaps the most crucial requirement for "qualified conservation contributions" is the "conservation purposes" test, i.e., that contributions be

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16/ The text of this new IRC sec. 170(h) is given in appendix I.

17/ "A land trust is a private, charitable organization that acquires and holds interests in land for the purpose of conserving the land in perpetuity." (Fenner 1980, p. 1042).

made "exclusively for conservation purposes." According to IRC sec. 170(h)(4)(A), these purposes include:

> (i) the preservation of land areas for outdoor recreation by, or for the education of, the general public;
> (ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem;
> (iii) the preservation of open space (including farmland and forest land) where such preservation is--
>   (I) for the scenic enjoyment of the general public; or
>   (II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy,
> and will yield a significant public benefit. 18/

The phrase "exclusively for conservation purposes" is further qualified in IRC sec. 170(h)(5), which has two subparts. Subpart A indicates that the conservation purposes must be protected in perpetuity. Subpart B disqualifies contributions where mineral rights are retained "if at any time there may be extraction or removal of minerals by any surface mining method." In other words, the "conservation purposes" test is not met whenever there is a possibility that surface mining might be undertaken on the property in the future.

Congressional Intent

The new IRC sec. 170(h) enacted as part of P.L. 96-541 contains several subjective phrases, such as "significant public benefit," "clearly delineated. . . governmental conservation policy," and "relatively natural habitat." Some insights into congressional intent with respect to these phrases can be

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18/ The preservation of historic land areas or structures is also included in IRC sec. 170(h)(4)(A). Since this report is focused on the preservation of natural areas, the historic preservation provisions of this section (and the accompanying IRS regulations) are not examined.

obtained from the report of the Senate Committee on Finance. 19/ For example, the numerous qualifications regarding the deductibility of conservation easement donations resulted from the Committee's belief "that it is not in the country's best interest to restrict or prohibit the development of all land areas" (S. Rep. 96-1007, p. 9). So the provisions of IRC sec. 170(h) were adopted to limit deductions to "unique or otherwise significant land areas" (S. Rep. 96-1007, p. 9). Additionally, the Committee wanted to ensure that the public benefit "furthered by the contribution would be substantial enough to justify the allowance of a deduction" (S. Rep. 96-1007, p. 10).

Preservation of open space. The "conservation purposes" test in IRC sec. 170(h) was addressed extensively in the Committee report. For instance, several examples of "significant natural habitats and ecosystems" were given to illustrate the intent of IRC sec. 170(h)(4)(A)(ii). 20/ However, the largest portion of the Committee report was devoted to the provisions regarding the preservation of open space.

19/ U.S. Congress. Senate. Committee on Finance. Tax Treatment Extension Act of 1980. Report to Accompany H.R. 6975. Senate Report No. 96-1007, 96th Cong., 1st Sess. Washington, U.S. Govt. Print. Off., 1980. (Hereafter cited as S. Rep. 96-1007)

20/ These examples included: habitats for rare, endangered, or threatened native species of animals, fish, or plants; natural areas that represent high quality examples of a native ecosystem terrestrial community, or aquatic community; and natural areas which are included in, or which contribute to the ecological viability of a local, State, or national park, nature preserve, wildlife refuge, wilderness area or other similar conservation area (S. Rep. 96-1007, p. 11).

> To satisfy the requirement of scenic enjoyment by the general public, visual, not physical, access by the general public to the property is sufficient. Thus, preservation of land may be for the scenic enjoyment of the general public if development of the property would interfere with a scenic panorama that can be enjoyed from a park, nature preserve, road, waterbody, trail, historic structure or land area, and such area or transportation way is open to, or utilized by, the public. (S. Rep. 96-1007, p. 11)

The "clearly delineated. . . governmental policy" language was "intended to protect the types of property identified by representatives of the general public as worthy of preservation or conservation" (S. Rep. 96-1007, p. 11). Examples of such policies include:

1. a Federal executive order pursuant to a Federal statute establishing a conservation program;
2. a State statute or local ordinance establishing a funded conservation program for a scenic river or other identified conservation project; and
3. an unfunded conservation program involving a significant commitment by the government. (S. Rep. 96-1007, p. 11)

Specific, individually-owned parcels need not be identified in these programs. On the other hand, the Committee made it clear that broad executive or legislative declarations in support of conservation do not constitute a "clearly delineated. . . governmental policy."

As noted earlier, "significant public benefit" must be obtained from all contributions made for the preservation of open space. According to the Committee, factors to be considered in making this determination include (but are not limited to):

1. Uniqueness of the property;
2. Intensity of current and foreseeable development in proximity to the property;
3. Consistency of the proposed open space use with other governmental conservation programs; and
4. Opportunity for the general public to enjoy the use of the property or to appreciate its scenic values. (S. Rep. 96-1007, p. 12)

The Committee cautioned that:

> The preservation of an ordinary tract of land would not. in and of itself, yield a significant public benefit, but the preservation of ordinary land areas in conjunction with other factors that demonstrate significant public benefit or the preservation of a unique land area for public enjoyment would yield a significant public benefit. (S. Rep. 96-1007, p. 12)

Several examples that illustrate its intent follow this passage. 21/ To reduce uncertainty prior to the issuance of implementing IRS regulations, the Committee suggested that taxpayers request a prior administrative determination with respect to meeting the "conservation purposes" test.

Other provisions. In order to be "exclusively for conservation purposes," a contribution

> . . . must involve legally enforceable restrictions on the interest in the property retained by the donor that would prevent uses of the retained interest inconsistent with the conservation purposes. (S. Rep. 96-1007, p. 13)

This was the rationale for disqualifying contributions whenever there is a possibility of future extraction or removal of minerals using surface mining methods. Similarly, the requirement that restrictions be perpetual was adopted to ensure that the restrictions are "enforceable by the donee organization (and successors in interest) against all other parties in interest (including successors in interest)" (S. Rep. 96-1007, p. 14). Although donees are not required to set aside funds for enforcement, the Committee made it clear that

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21/ Examples of contributions that would provide "significant public benefit" included: the preservation of farmland pursuant to a State program for flood prevention and control; the preservation of a unique natural land formation for the enjoyment of the general public; the preservation of woodland along a Federal highway pursuant to a governmental program to preserve the appearance of the area so as to maintain the scenic view from the highway; and the preservation of a stretch of undeveloped oceanfront property located between a public highway and the ocean so as to maintain the scenic ocean view from the highway (S. Rep. 96-1007, p. 12).

donees must "have the commitment and the resources to enforce the perpetual restrictions and to protect the conservation purposes" (S. Rep. 96-1007, p. 14). Finally, the Committee indicated that conservation easements and other restrictions were not to be transferred, except to other qualified organizations that would protect the conservation purposes.

Valuation of conservation easements. Although not actually addressed in the legislation, the Committee report also commented on the valuation of conservation easements. In general, the tax deduction for qualifying contributions is based on the fair market value of the interest conveyed. Fair market value is defined as "the price at which the property would change hands between a willing buyer and a willing seller" (S. Rep. 96-1007, p. 14). Since markets for partial interests in real property are generally not well established, the Committee acknowledged that there may be few comparable sales available for determining the fair market value of these interests. In these cases a before-and-after approach was advocated. The value of a conservation easement is defined as the difference "between the fair market value of the property before and after the grant of the easement" (S. Rep. 96-1007, p. 15). 22/

The "before" valuation of the property

> should take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would be developed. (S. Rep. 96-1007, p. 15)

Zoning, conservation programs, and other laws that restrict the use of the property are also to be taken into account. Additionally, the Committee indicated that when restrictions on one parcel result in an increase in the value of adjacent property, the impact on the adjacent property should be considered. 23/

22/ This before-and-after approach for valuing conservation easements was set forth in a 1973 Revenue Ruling (73-339). For a discussion of this and subsequent rulings, see Kinnamon (1980, pp. 12-14).

23/ The treatment of this enhancement or "betterment" of adjacent property is examined in more detail later in this report.

PROPOSED IRS REGULATIONS

The IRS published proposed regulations to implement sec. 6 of P.L. 96-541 on May 23, 1983. 24/ Most of the proposed regulations pursuant to this section would be contained in a new sec. 1.170A-13 of title 26 of the Code of Federal Regulations (CFR). In addition to restating the provisions of the new IRC sec. 170(h), established by P.L. 96-541, these proposed regulations incorporate much of the language from the Senate Finance Committee report. Several crucial provisions of the proposed regulations are discussed below.

Preservation of Open Space

A major portion of the proposed IRS regulations is devoted to IRC sec. 170(h)(4)(A)(iii), which requires donations to yield "significant public benefit" and either be "pursuant to clearly delineated. . . governmental policy" or "for the scenic enjoyment of the general public." The subjective nature of scenic enjoyment is acknowledged in the proposed regulations. Nevertheless, a list of factors that could be considered in evaluating scenic enjoyment is given:

1. The compatibility of the land use with other land in the vicinity;
2. The degree of contrast and variety provided by the visual scene;

24/ U.S. Dept. of the Treasury. Internal Revenue Service. Qualified Conservation Contribution; Proposed Rulemaking. Federal Register, v. 48, no. 100, May 23, 1983: 22940-22949. (Hereafter cited as Fed. Reg. 1983)

> 3. The openness of the land (which would be a more significant factor in an urban or densely populated setting or in a heavily wooded area);
> 4. Relief from urban closeness;
> 5. The harmonious variety of shapes and textures;
> 6. The degree to which the land use maintains the scale and character of the urban landscape to preserve open space, visual enjoyment, and sunlight for the surrounding area;
> 7. The consistency of the proposed scenic view with a methodical state scenic identification program, such as a state landscape inventory; and
> 8. The consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently rigorous review process, especially if the donation is endorsed by an appropriate state agency (Fed. Reg. 1983, p. 22943).

The proposed regulations indicate that different factors may be appropriate in different settings due to regional variations in topography, geology, biology, and other conditions. As suggested in the Committee report, only visual access to donated scenic property is required. Further,

> the entire property need not be visible to the public. . . although the public benefit from the donation may be insufficient if only a small portion of the property is visible to the public. (Fed. Reg. 1983, p. 22943)

The proposed IRS regulations state that a "general declaration of conservation goals by a single official or legislative body" (Fed. Reg. 1983, p. 22943) does not constitute a "clearly delineated. . . governmental conservation policy." Several examples of specific, identifiable conservation projects that do qualify with respect to this provision are listed, however. 25/ Interestingly, the proposed regulations indicate that acceptance

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25/ Included in this list are: the preservation of a wild or scenic river; the preservation of farmland pursuant to a State program for flood prevention and control; and the protection of the scenic or ecological character of land that is contiguous to, or an integral part of, the surroundings of existing recreation or conservation sites (Fed. Reg. 1983, p. 22943).

of an open space easement by a governmental agency does not automatically meet this requirement. However,

> the more rigorous the review process by the governmental agency, the more the acceptance of the easement tends to establish the requisite clearly delineated governmental policy. (Fed. Reg. 1983, p. 22943)

Irrespective of governmental conservation policies and scenic attributes of property, all open space easement donations must yield a "significant public benefit" to be tax deductible. Among the factors that may be germane to the evaluation of public benefit, according to the proposed IRS regulations, are:

1. The uniqueness of the property to the area;
2. The intensity of land development in the vicinity of the property (both existing development and foreseeable trends of development);
3. The consistency of the proposed open space use with public programs (whether Federal, State or local) for conservation in the region;
4. The consistency of the proposed open space use with existing private conservation programs in the area, as evidenced by other land, protected by easement or fee ownership by qualified organizations, in close proximity to the property;
5. The likelihood that development of the property would lead to or contribute to degradation of the scenic, natural, or historic character of the area;
6. The opportunity for the general public to use the property or to appreciate its scenic values;
7. The importance of the property in preserving a local or regional landscape or resource that attracts tourism or commerce to the area;
8. The likelihood that the donee will acquire equally desirable and valuable substitute property or property rights;
9. The cost to the donee of enforcing the terms of the conservation restriction;
10. The population density in the area of the property; and
11. The consistency of the proposed open space use with a legislatively mandated program identifying particular parcels of land for future protection. (Fed. Reg. 1983, p. 22943-4)

Several illustrations of contributions that would yield significant public benefit are provided. 26/

Exclusively for Conservation Purposes

IRC sec. 170(h)(5) articulates the meaning of "exclusively for conservation purposes." The proposed regulations for implementing this subsection are 26 CFR 1.170A-13(e) and 1.170A-13(g). In subsection (e), public access is specified as a requirement for deductibility unless such access must be limited for the protection of the conservation interests. 27/ Limiting public access to protect the habitat of a threatened animal species is an example of this exception.

The proposed regulations indicate that generally

> a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests. (Fed. Reg. 1983, p. 22945)

For instance, a deduction would not be allowed for the preservation of farmland in conjunction with a State program for flood prevention if pesticide usage on the farmland might destroy a significant ecosystem. Additionally, property interests retained by the donor (and the donor's successors)

> must be subject to legally enforceable restrictions that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation. (Fed. Reg. 1983, p. 22945)

26/ The illustrations given in the proposed regulations are identical to the ones given in the Committee report accompanying P.L. 96-541 (see footnote 21).

27/ This public access requirement seems to contradict the previously discussed provision that only visual access to scenic property is required.

In particular, a deduction would not be allowed if at any time minerals may be removed in a manner that is inconsistent with the particular conservation purposes of a contribution.

Whenever a donor retains some property interests that might adversely impact the conservation purposes of the contribution, the proposed IRS regulations require substantial documentation of the condition of the property at the time of the gift. This documentation may include:

1. Survey maps from the U.S. Geological Survey;
2. Scale-drawn maps showing man-made improvements, vegetation, land use history, and distinct natural features;
3. Aerial photographs; and
4. On-site photographs. (Fed. Reg. 1983, p. 22946)

This documentation "must be accompanied by a statement signed by the donor and a representative of the donee clearly referencing the documentation" (Fed. Reg. 1983, p. 22946) and attesting to its accuracy. Donors must notify donees before exercising potentially destructive, retained property interests (e.g., mineral rights), and the donee must have the right to inspect the property to monitor compliance with the terms of the donation.

Provisions for the termination of conservation easements are contained in the proposed 26 CFR 1.170A-13(g)(5). In particular, termination must be preceded by a judicial ruling that continued use of the property for conservation purposes is impossible or impractical due to an unexpected change in the conditions surrounding the property. Additionally, the donee's portion of the proceeds from the sale of the property must be "used by the donee organization in a manner consistent with the conservation purposes of the original contribution" (Fed. Reg. 1983, p. 22946). The donee's portion of the proceeds is based upon the original proportionate value of the conservation easement.

Valuation of Conservation Easements

The proposed 26 CFR 1.170A-13(h)(3) is devoted to the valuation of conservation easements. The use of the before-and-after approach to valuation is supported in this section, and cases where conservation easements result in the betterment of adjacent property are discussed in detail. Specifically, if a conservation easement only applies to a portion of the donor's land, the before-and-after approach is applied to the donor's entire property. This ensures that the donor does not get a deduction for benefits accruing to his property adjacent to the land encumbered by the easement. Similarly, the impacts of a conservation easement on adjacent land owned by the donor's relatives are also to be taken into account. Betterment is ignored only when the adjacent landowners are unrelated to the donor.

Whenever the donor retains some property interests, the adjusted basis 28/ of the retained property is reduced using the ratio of the "after" value to the

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28/ The adjusted basis of real property is its original cost plus the cost of capital improvements. Whenever property is sold, capital gains for tax purposes are defined as the difference between the sale price and the adjusted basis.

"before" value. Numerous examples are given in the proposed 26 CFR 1.170A-13(h)(4) to illustrate the determination of the value of conservation easements. 29/

29/ The following example is representative. Assume that E owns 10 one-acre lots that are currently woods and parkland. The fair market value of each of E's lots is $15,000, and the basis of each lot is $3,000. E grants to the county a perpetual easement for conservation purposes to use and maintain eight of the acres as a public park and to restrict any future development on those eight acres.

As a result of the restrictions, the value of the eight acres is reduced to $1,000 an acre. However, by perpetually restricting development on this portion of the land, E has ensured that the two remaining acres will always be bordered by parkland, thus increasing their fair market value to $22,500 each. If the eight acres represented all of E's land, the fair market value of the easement would be $112,000, an amount equal to the fair market value of the land before the granting of the easement (8 x $15,000 = $120,000) minus the fair market value of the encumbered land after granting the easement (8 x $1,000 = $8,000). However, because the easement only covered a portion of the taxpayer's contiguous land, the amount of the deduction under section 170 is reduced to $97,000 ($150,000 - $53,000), that is, the difference between the fair market value of the entire tract of land before ($150,000) and after ((8 x $1,000) + (2 x $22,500)) the granting of the easement.

Since the easement covers a portion of E's land, only the basis of that portion is adjusted. Therefore, the amount of basis allocable to the easement is $22,400 ((8 x $3,000) x ($112,000/$120,000)). Accordingly, the basis of the eight acres encumbered by the easement is reduced to $1,600 ($24,000 - $22,400), or $200 for each acre. The basis of the two remaining acres is not affected by the donation (Fed. Reg. 1983, p. 22948).

CONCERNS ABOUT PROPOSED IRS REGULATIONS

Hearings on the proposed IRS regulations pursuant to IRC sec. 170(h) were held in Washington, D.C., on September 15, 1983. In addition to the testimony of people appearing at these hearings, the IRS received over 100 written comments on the proposed regulations. While a thorough analysis of the concerns expressed regarding the provisions of these proposed regulations is beyond the scope of this report, the most significant concerns are discussed below. 30/

Preservation of Open Space

Many commentors expressed some concerns about 26 CFR 1.170A-13(d)(4), which contains the proposed requirements for donations for the preservation of open space. As noted above, acceptance of a conservation easement donation by a governmental agency would not automatically fulfill the "conservation purposes" requirement. Many commentors disagreed with this provision. Since the acceptance of conservation easements obligates the donee organization to monitoring and enforcement activities, they argued that governmental agencies would not accept an easement donation unless that donation would further a specific conservation policy and yield a significant public benefit.

Despite the specificity of the proposed regulations regarding the criteria for "scenic enjoyment" and "significant public benefit," it was noted that

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30/ This discussion is based upon reviews of written comments by Browne, ed. (1983) and Emory (1983). These documents can be obtained from the Land Trust Exchange, Mount Desert, Maine 04660.

natural resource expertise would be needed to make final determinations of compliance with the criteria. The IRS does not currently have the necessary expertise, but many private and public conservation organizations do. Hence, many commentors suggested that the IRS should specify guidelines that these organizations should use in accepting conservation easement donations, rather than trying to specify criteria that individual parcels must meet. In other words, it was suggested that IRS should let qualified conservation organizations make the determination regarding the scenic importance and social significance of individual donations; IRS would only delineate the process that these organizations would have to follow in making this determination. This would allow the IRS to focus its attention exclusively on the valuation of conservation easements, i.e., the amount of the charitable deduction.

Finally, the proposed regulations clearly indicate that the preservation of farmland solely for its food and fiber production capability would not satisfy the "conservation purposes" test. This provision was opposed by many commentors. The Federal Farmland Protection Policy Act (Subtitle I, Title XV, P.L. 97-98, enacted in December 1981) and the numerous State and local farmland retention programs were cited as evidence that the preservation of high-quality farmland for food and fiber production is a legitimate conservation pursuit in its own right.

Public Access

The requirement of physical access by the general public in the proposed regulations (26 CFR 1.170A-13(e)(2)) was condemned by virtually every commentor. Most of these commentors noted that there is no statutory authority for this requirement nor is it supported by the Committee report. There was a consensus that this public access requirement (if contained in the final regulations) had "the potential to stop easement programs totally" (Emory 1983, p. 4).

Inconsistent Uses

Although many commentors supported the restriction on inconsistent uses, most indicated that the determination of inconsistent uses should be left to the donee organizations. These organizations (not the IRS) have the expertise and knowledge of local circumstances that would be necessary to make this determination. Some commentors favored the deletion of this entire section, arguing that allowing some inconsistent uses would be preferable to losing an important natural area.

Mineral Rights

Many commentors opposed the treatment of retained mineral rights in the proposed regulations. Specifically, deductions for conservation easement donations are not allowed whenever a third party owns the mineral rights to the property. In the West and parts of the South, many landowners did not get the mineral rights when they purchased their property. Thus, the proposed regulations would preclude tax deductions for conservation easement donations by these landowners. Several commentors argued that this was not the intent of Congress. Others suggested that deductions be allowed when a third party has the mineral rights if there is very little likelihood of extraction or of harm to the conservation purpose if extraction should occur.

Summary

In addition to the concerns just discussed, comments were received on many other aspects of the proposed regulations, including the valuation of easements, documentation requirements, use of proceeds from a sale following termination of conservation easements, and rules regarding prior transfers. In general, there was widespread agreement that the proposed regulations failed "to provide the certainty that donors and their tax advisors need as to what will be deductible" (Emory 1983, p. 1). It was felt that the public access requirements and other burdens imposed on donors by these regulations would stop almost all donations of conservation easements. Furthermore, it was argued that

> The IRS has neither the experience nor the manpower to make natural resource management decisions. Such decisions are better made by land conservation and/or management agencies, whether government or private, and by people knowledgeable about the particular area in which an easement property is located. (Emory 1983, p. 1)

PROPOSED LEGISLATIVE CHANGES

Since the enactment of IRC sec. 170(h) in the Tax Treatment Extension Act of 1980, several bills have been introduced in Congress to change Federal tax policy with respect to donations of conservation easements. The bills introduced in the 98th Congress are briefly summarized below.

Wallop Bill (S. 1675)

Sen. Malcolm Wallop has introduced a bill (S. 1675) that would make significant changes in Federal tax incentives for charitable donations of real property for conservation purposes. Sen. Wallop's bill is cited as the Public Lands Acquisition Alternatives Act. Section 2(a) of S. 1675 would increase the allowable annual deduction for charitable contributions of capital gain property for qualified conservation purposes from the current 30 percent up to 50 percent of a taxpayer's adjusted gross income. 31/ Section 2(a) would also remove the current five-year limit on the carry-over of unused charitable deductions. These changes would ensure that the full value of all donations would be tax deductible.

Section 2(b) of S. 1675 specifies that gifts of a "qualified real property interest" to a governmental entity for the preservation of open space (including farmland and forest land) would be considered a "qualified

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31/ The current limit on total charitable contributions of 50 percent of a taxpayer's adjusted gross income would not be changed by this bill. Thus, donations for non-conservation uses would reduce the allowable deduction for conservation gifts below 50 percent.

conservation contribution." Thus, a donation of development rights on farmland to a State agency would automatically qualify as a conservation contribution. Sec. 2(b) would essentially abolish the "conservation purpose" test for open space easements donated to governmental agencies.

Under section 107(h)(5)(B) of the current Internal Revenue Code, if mineral rights are retained by the donor (or someone else) and there is even a remote possibility of future extraction or removal of minerals using surface mining methods, a donation does not satisfy the "conservation purpose" test. Section 2(c) of the Wallop bill would repeal this restriction. However, the future exercise of retained mineral rights would still have to be consistent with the original conservation objective.

As noted previously, IRC sec. 170(f)(3) currently allows a tax deduction for contributions of the following partial interests: a remainder interest in a personal residence or farm; an undivided portion of a taxpayer's entire interest in property; and a "qualified conservation contribution." Section 3 of S. 1675 would also allow a tax deduction for a contribution of a taxpayer's entire interest in real property other than a qualified mineral interest. In other words, a gift of a taxpayer's fee-simple interest excluding the mineral rights would not have to meet the "conservation purpose" test in order to be deductible. This represents a potentially significant broadening of the current statute.

Sections 4 and 5 of the Wallop bill pertain to estate taxes. Section 4 would allow estate taxes to be reduced by the full value of a "qualified conservation contribution" to the U.S. Government. Thus, the value of conservation easements that are donated to the Federal Government could be used as a credit against estate taxes. 32/ Additionally, section 5 would permit the carry-over of unused charitable deductions to be subtracted from the taxable estate of the decedent. In other words, the income tax deduction that the decedent was not able to use could be deducted from the valuation of the decedent's estate prior to the determination of estate taxes. 33/

Farmland Development Rights

Two companion bills (S. 1773 and H.R. 2119) introduced in the 98th Congress would add a new IRC sec. 170(i) pertaining to development rights on farmland. Specifically, this proposed subsection would allow a charitable deduction for the difference between the fair market value of farmland development rights and the amount received from the sale of these rights. In other words, if taxpayers sell their farmland development rights at less than their fair market value, the difference could be deducted as a charitable contribution. Eligible recipients would include any State or political subdivision thereof and any qualified organization under IRC sec. 170(h)(3). In order to qualify for this deduction, the land must qualify under a State or local farmland preservation program that provides for the purchase of farmland development rights.

In addition to this provision regarding farmland development rights, H.R. 2119 would also add a new sec. 170(h)(4)(C) to the Internal Revenue Code relating to the "conservation purpose" test for donations of open space

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32/ A similar provision is contained in H.R. 2871, sponsored by Rep. Robert Lagomarsino.

33/ The remaining sections of S. 1675 relate to capital gains taxes on the sale of conservation easements.

easements. In particular, such donations would be pursuant to a "clearly delineated. . . governmental conservation policy" and would yield a "significant public benefit" if the donee is a governmental unit or if a governmental unit certifies that these requirements are met by a donation. In either case, the governmental unit must agree to enforce the conservation easement.

Other Bills

P.L. 98-11, which was signed by President Reagan on March 28, 1983, amends the National Trails System Act by designating additional national scenic and historic trails. Additionally, sec. 207(i) of P.L. 98-11 provides that donations of conservation easements that preserve or enhance components of the national trails system "shall be deemed to further a Federal conservation policy and yield a significant public benefit for purposes of section 6 of Public Law 96-541." Eligible properties (i.e., properties where conservation easements would preserve or enhance components of the national trails system) must be determined by the appropriate Secretary (Agriculture or Interior). In effect, P.L. 98-11 allows Federal agencies to designate areas in proximity to national trails where donations of conservation easements will automatically qualify for tax deductions.

Similar provisions are contained in several other bills introduced in the 98th Congress. For example, S. 1756 provides for assistance to State and local governments and private interests for the conservation of certain rivers. Sec. 601 of this bill would also authorize conservation easement donations that conserve or enhance the values of rivers included in State, local, or Federal river programs, assessments, or inventories and environs thereof (as determined by the appropriate Governor or Secretary). 34/ The agency responsible for the management or supervision of the pertinent river would have to concur in the donation. As in P.L. 98-11, S. 1756 specifically states that these donations would satisfy the "conservation purposes" test in IRC sec. 170(h).

Companion bills H.R. 2809 and S. 1271 would create a U.S./National Fish and Wildlife Foundation. Sec. 5 of these bills provides that donations of conservation easements to this foundation "shall be deemed to further a governmental conservation policy and yield a significant public benefit for purposes of sec. 6 of Public Law 96-541." Although the conservation of fish and wildlife resources would be its principal focus, this foundation would be authorized to accept conservation easements that further a wide variety of conservation objectives.

Finally, H.R. 2379, which provides for the protection and management of the national park system, would stimulate donations of conservation easements on certain land. Specifically, H.R. 2379 would require the Director of the National Park Service to assist potential conservation easement donors (upon their written request) in satisfying the requirements of IRC sec. 170(h), if the Director determined that the conservation easement would protect or enhance a unit of the national park system. The assistance provided by the Director would include (but not be limited to) providing for a professional valuation of the conservation easement and a statement regarding the importance of the contribution.

34/ Sec. 312 of S. 1084 would authorize conservation easement donations that preserve or enhance the values of rivers in the National Wild and Scenic Rivers System.

SUMMARY

As summarized in table 1, there have been many changes in Federal tax policy with respect to the deductibility of conservation easement gifts in a relatively short period of time. Despite a lack of explicit statutory authority, the IRS allowed tax deductions for donations of conservation easements to charitable organiations (primarily land trusts) for several years. After some legislative action in 1976 and 1977, significant restrictions on what constitutes a "qualified conservation contribution" were enacted as part of the Tax Treatment Extension Act of 1980. This act effectively shifted "some of the land selection and management decisions previously made by land trusts" (Browne 1983, p. 66) to the Internal Revenue Service. Somewhat controversial regulations to implement this act were proposed by the IRS in 1983. During this same year, several bills were introduced in the 98th Congress to increase the tax benefits from conservation easement gifts and broaden the eligibility criteria for these tax benefits.

Donations of conservation easements to qualifying land trusts represent a cost-effective alternative to governmental fee simple purchase and regulatory approaches for preserving many natural areas. However, uncertainties stemming from the Tax Treatment Extension Act and proposed IRS regulations have allegedly resulted in a precipitous decline in the use of this alternative. Consequently, additional legislative changes are being considered to enhance realization of the full potential of conservation easement gifts as an approach to preserving natural areas.

TABLE 1. Chronology of Major Events in the Evolution of Federal Tax Policy Regarding Deductions for Donations of Conservation Easements

1964 IRS Revenue Ruling 64-205

Income tax deduction first allowed for a conservation easement donation to the Federal Government.

1969 Tax Reform Act (P.L. 91-172)

Denied income tax deductions for donations of partial interests in real property, except for (among others) undivided portions of a taxpayer's entire interest in the property. A Conference Committee report indicated that perpetual conservation easements were to be considered undivided interests, and, therefore, were deductible from income taxes. Furthermore, P.L. 91-172 extended this deduction to gift and estate taxes.

1972 Adoption of 26 CFR 1.170A-7

Regulations on contributions of partial interests in real property pursuant to P.L. 91-172. These regulations upheld the "undivided interest" exception for donations of perpetual conservation easements.

1976 Tax Reform Act (P.L. 94-455)

Allowed tax deductions for donations of conservation easements having a term of at least 30 years given to "qualified organizations," "exclusively for conservation purposes." This provision had an expiration date of June 14, 1977.

1977 Tax Reduction and Simplification Act (P.L. 95-30)

Extended the expiration date of P.L. 94-455 to June 14, 1981, but eliminated deductions for term easements. Thus, all perpetual conservation easements apparently had to meet the "conservation purposes" test (specified in P.L. 94-455) in order to be tax deductible.

1980 Tax Treatment Extension Act (P.L. 96-541)

Modified the list of deductible partial interest contributions to include a "qualified conservation contribution." This type of contribution was defined in a new IRC sec. 170(h) as having to be a "qualified real property interest" made to a "qualified organization," "exclusively for conservation purposes." Perpetual conservation easements are one of the "qualified real property interests."

1983 Draft of 26 CFR 1.170A-13

Proposed regulations to implement the new IRC sec. 170(h) enacted in P.L. 96-541.

1983 S. 1675, S. 1773, H.R. 2119, and others

Bills introduced in the 98th Congress to change Federal tax policy with respect to donations of conservation easements.

APPENDIX

IRC sec. 170(h)

(h) Qualified conservation contribution. ----

(1) In general. ---- For purposes of subsection (f)(3)(B)(iii), the term "qualified conservation contribution" means a contribution ----

(A) of a qualified real property interest,

(B) to a qualified organization,

(C) exclusively for conservation purposes.

(2) Qualified real property interest. ---- For purposes of this subsection, the term "qualified real property interest" means any of the following interests in real property:

(A) the entire interest of the donor other than a qualified mineral interest,

(B) a remainder interest, and

(C) a restriction (granted in perpetuity) on the use which may be made of the real property.

(3) Qualified organization. ---- For purposes of paragraph (1), the term "qualified organization" means an organization which ----

(A) is described in clause (v) or (vi) of subsection (b)(1)(A), or

(B) is described in section 501(c)(3) and ----

(i) meets the requirements of section 509(a)(2), or
(ii) meets the requirements of section 509 (a)(3) and is controlled by an organization described in subparagraph (A) or in clause (i) of this subparagraph.

(4) Conservation purpose defined. ----

(A) In general. ---- For purposes of this subsection, the term "conservation purpose" means ----

(i) the preservation of land areas for outdoor recreation by, or the education of, the general public,
(ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,
(iii) the preservation of open space (including farmland and forest land) where such preservation is ----

(I) for the scenic enjoyment of the general public, or
(II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy,

and will yield a significant public benefit, or

(iv) the preservation of an historically important land area or a certified historic structure.

(B) Certified historic structure. ---- For purposes of subparagraph (A)(iv), the term "certified historic structure" means any building, structure, or land area which ----

(i) is listed in the National Register, or
(ii) is located in a registered historic district (as defined in section 48(g)(3)(B)) and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

A building, structure, or land area satisfies the preceding sentence if it satisfies such sentence either at the time of the transfer or on the due date (including extensions) for filing the transferor's return under this chapter for the taxable year in which the transfer is made.

(5) Exclusively for conservation purposes. ---- For purposes of this subsection ----

(A) Conservation purpose must be protected. ---- A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

(B) No surface mining permitted. ---- In the case of a contribution eral interest, subparagraph (A) shall not be treated as met if at any time there may be extraction or removal of minerals by any surface mining method.

(6) Qualified mineral interest. ---- For purposes of this subsection, the term "qualified mineral interest" means ----

(A) subsurface oil, gas, or other minerals, and

(B) the right to access to such minerals.

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